

DRAFT FINAL REPORT

**Evaluation
of the
Privatization and Enterprise Restructuring Project
(Contract No. 180-0014)**

RFC No. AEP-0003-1-00-3003-00, Delivery Order No. 3

Submitted to:

EUR/OPPA
Agency for International Development
Washington, DC

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March 25, 1993

TABLE OF CONTENTS

EXECUTIVE SUMMARY	i
1. INTRODUCTION	1
1.1 Key Issues in Privatization	2
1.2 Overview of AID's Privatization Program in Central Europe	3
1.3 Evaluation Methodology	5
1.4 Structure of the Report	5
2. ALTERNATIVE PRIVATIZATION APPROACHES	6
2.1 Overview on Four Basic Approaches	6
2.2 Policy and Program Support	9
2.2.1 Overall Effectiveness and Impact of Assistance	9
2.2.2 Country Overviews	12
2.2.3 Mass Privatization	13
2.2.4 Privatization through Restructuring	15
2.2.5 Financial Sector Programs	16
2.2.6 Other Programs and Issues	19
2.2.6.1 Health Care	19
2.2.6.2 Other donors	19
2.2.6.3 Other AID Projects	20
2.3. Assistance to Government Agencies	21
2.3.1 Overall Effectiveness	21
2.3.2 Crimson Capital/Deloitte & Touche	22
2.3.2.1 Description of Crimson Capital/D&T	22
2.3.2.2 Analysis of Crimson Capital/D&T	23
2.3.2.3 Conclusions on the "Crimson" Program	25
2.3.3 State Property Agency (SPA)	26
2.3.3.1 Description of the SPA	26
2.3.3.2 Analysis of SPA	27
2.3.3.3 General Conclusions	28
2.3.4 Self-Privatization/Pri-Man Project/Hungary	28
2.3.4.1 Description of Pri-Man	28
2.3.4.2 Analysis and Conclusions for Self-Privatization/Pri-Man	29
2.3.5 Securities Exchange Commission/Poland	30
2.4 Assistance to Individual Enterprises	31
2.4.1 Assistance to Individual Enterprises - Large Firms	31
2.4.1.1 Overall Effectiveness	31
2.4.1.2 Complicating Factors in Large Firm Privatizations ..	32
2.4.1.3 Role of AID Assistance	33
2.4.2 Assistance to Individual Enterprises - Small and Medium Firms ..	34
2.4.2.1 Overall Effectiveness	34

2.4.2.2	Complicating Factors in "Buckshot" Approach	35
2.4.3	The Sectoral Approach	36
2.4.3.1	Description and Rationale	37
2.4.3.2	Cost-effectiveness	37
2.4.3.3	A pilot operation	38
2.4.4	Foreign Investment	39
2.4.4.1.	Potential Services for Facilitating Foreign Investment	39
2.4.4.2.	AID-Financed Investment Services	40
2.4.4.3.	Issues Pertaining to Foreign Investment	40
2.4.5	Overall Administration of Firm-Specific Transactions	41
2.5	Assistance in Monitoring and Training	42
2.5.1	Summary of Section	42
2.5.2	Amounts and Types of Assistance Rendered	42
2.5.3	Training Assistance by Country	43
2.5.4	Impact and Results	48
2.5.5	General Conclusions and Recommendations	48
2.5.5	Country Specific Conclusions and Recommendations	50
3.	COUNTRY SPECIFIC ASSESSMENTS	52
3.1	Overview	52
3.2	Czech Republic	52
3.2.1	Distribution of Program Activities	52
3.2.2	Comparison with Phase I Country Assessment Conclusions	53
3.2.3	AID's Role in the Privatization Process	55
3.2.4	Future Issues	56
3.3	Poland	59
3.3.1	Distribution of Program Activities	59
3.3.2	Comparison with Phase I Country Assessment Conclusions	62
3.3.3	AID's Role in the Privatization Process	65
3.3.4	Future Issues	66
3.4	Hungary	70
3.4.1	Distribution of Program Activities	70
3.4.2	Comparison with Phase I Country Assessment Conclusions	72
3.4.3	AID's Role in the Privatization Process	73
3.4.4	Future Aid Issues	75
4.	SUMMARY: HAS AID ASSISTANCE MADE A SIGNIFICANT DIFFERENCE? . .	80
4.1	Measurement of Impact	80
4.2	Actual Impact	81
4.2.1	Overall AID Impact	81
4.2.2	Employment and Social Issues	83
4.2.3	Gender Impact	85
4.3	Proposed Indicators for Future Monitoring of Impact	86

5. LESSONS LEARNED AND FUTURE STRATEGIC IMPLICATIONS	88
5.1 Lessons Learned	89
5.2 Proposed AID Assistance Strategy	91
5.2.1 Types of Assistance to Continue or Expand	92
5.2.2 Types of Assistance to Discontinue or Postpone	93
5.2.3 New Initiatives or Complementary Assistance	93
5.3 Country Specific Strategies	94
5.3.1 Czech Republic	94
5.3.2 Poland	94
5.3.3 Hungary	94
5.3.4 Southern Tier and Baltics	94
5.4 Future Issues	95

Appendix 1 - Evaluation Scope of Work

Appendix 2 - List of PIOT Work Orders for the Czech Republic, Poland and Hungary

Appendix 3 - List of People Interviewed

Appendix 4 - Description of the Treuhandonstadt Privatization Program

Appendix 5 - A Proposed Framework for Structuring, Delivering, and Managing Structured
On-The-Job Training

Appendix 6 - Performance Impact Indicators

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EXECUTIVE SUMMARY

Since mid-1991 AID has obligated \$44.5 million under the "Privatization and Enterprise Restructuring Project" for 54 privatization projects in 11 countries. In the three countries that are the focus of this study -- the Czech Republic, Poland, and Hungary-- AID has financed 44 projects totaling more than \$31 million or about two-thirds of total program funding.

This study evaluates the effectiveness and efficiency with which AID funds have been invested in privatization activities in these three countries. On a general level, it examines the extent to which AID assistance has helped governments develop a legal and institutional framework for privatization. At the firm level, it looks at whether the project has assisted firms in strengthening management and adjusting to open, competitive markets.

At both levels, the key questions posed in this evaluation include:

- Which projects have been successful and which have not?
- Can we identify a pattern that helps predict success?
- What are the key lessons learned and recommendations for future program activities?

A. MAJOR FINDINGS

On balance, the results of AID's privatization initiatives in the Czech Republic, Poland and Hungary have been mixed. Out of a total of \$31.3 million dollars obligated for projects, it is estimated that about 60% of the expenditures have either resulted in outright successes (37%) or mixed success (23%). The remaining projects were either too incomplete to define or resulted in no tangible political or economic benefits.

AID assistance has been most successful in developing institutional structures and the regulatory/legal framework for implementing privatization programs. More problematic has been assistance to individual enterprises. Both sector studies and firm-specific technical assistance have typically had a low success ratio and are generally not cost effective.

Some of the more notable successful projects have included: 1) institutional support rendered to the Czech Ministry of Privatization through Crimson Capital/D&T, 2) assistance to the Mass Privatization Program in Poland 3) work with the Czech Savings Bank in the Czech Republic, 4) development of ESOPs program in Hungary, 5) financial sector regulation assistance in Poland, and 6) policy advice in Hungary.

These projects either: 1) helped effect or speed up actual privatizations; 2) established necessary financial, institutional structures for future privatizations and market development; 3)

achieved concrete economic benefits (e.g. increased purchase prices, investment); or 4) provided unanimous and tangible political benefits.

Key "factors of success" associated with these projects include:

- * **Focused Towards the Middle or End of the Privatization Cycle:** Successful projects were generally undertaken in the middle of the privatization sequence (e.g. development of procedures or policy guidelines) or even towards the end when privatization proposals are being implemented. Assistance for initial market/sector analysis were often subject to floundering and had a low success rate because the targets were scattered.
- * **Clearly Defined Objectives:** The more precisely focused a project was in its objectives, the more likely it was to be successful.
- * **Strong Government and AID Support:** All these projects had clear government support and a willingness to act without other factors, usually political, paralyzing this will. In addition, support from AID/Washington and the local AID/Rep was coordinated and flowed smoothly without disruptive starts and stops.

For each type of privatization assistance approach--policy/program support, institutional support and firm-specific transaction assistance-- there are many trade-offs. The arguments for and against a policy/program support initiative include:

<u>Pros</u>	<u>Cons</u>
* Important to top level government concerns	* Hard to quantify impact
* Permits introduction of high profile/high impact experts	* Other donors--e.g. IBRD and PHARE have competitive advantage with more resources
* Most pervasive way to establish transparency	* Long time horizon to achieve results
* Deals with a program from start to finish.	

The strengths and weaknesses of providing institutional support include:

<u>Pros</u>	<u>Cons</u>
* Processes are easy to define	* Hard to quantify impact
* Permits alternating long and short term assistance	* Good long term advisors hard to locate and contract
* Helps establish credibility and consistency	* Hard to keep projects focused.
	* Without political consensus, may add to bureaucracy without speeding things up.

Finally, support for sector studies and firm-specific assistance reveals the following trade-offs:

<u>Pros</u>	<u>Cons</u>
* Most direct way to make privatization happen.	* High rate of failure
* Improves enterprise management skills.	* Costly; not cost-effective
* High visibility to government	* Long time to bring to fruition.

B. LESSONS LEARNED

1. The division in contract management between AID/Washington and the field has not made the IQC mechanism a very effective instrument.

PO's Contract management is centered in AID/Washington which has consistently been understaffed, had high turnover rates, and not always had the funds to visit the field on a regular basis.

These constraints, along with fast changing demands in the field, have led to disagreements over project objectives and delays in funding which have hurt AID credibility.

In the future, decision-making authority should be delegated to the field. This is especially important for IQC contracts which are supposed to provide timely and responsive assistance.

2. **An ad hoc, reactive privatization strategy can be convenient and positive in the short run, but problematic thereafter.**

need to focus on sector & key subsectors

A decentralized, reactive privatization strategy in which program initiatives are defined by government demands and/or marketing efforts of contractors in country can help generate political support and goodwill. It also can be useful for testing a variety of experimental interventions.

However, the continued application of an ad hoc, "buckshot" strategy can eventually lead to dissipation of resources and in the absence of concrete results, weakening of political support for a program. Also, having the host government set the rules for project conduct is not always a reliable guide. Often times, governments have too many mixed agendas on their minds.

3. **AID privatization assistance should be focused yet still diversified.**

Making privatizations happen is risky business. There are many economic and political tradeoffs and choices that have to be made regarding types of companies to assist and objectives to be achieved.

Most notably, AID assistance should balance foreign transaction assistance with domestic privatization support. Project emphasis on foreign investors can produce quick, short term economic benefits. But they should not be carried out to the point that longer term domestic issues and constraints are overlooked (e.g. restructuring, promotion of domestic investment).

4. **Facilitating the privatization process is better than promoting a single company.**

AID is best at "facilitating" privatization processes rather than "promoting" one particular privatization transaction. Industry specific, "promotion" activities are resource intensive and take longer to achieve their objectives than facilitation activities.

C. RECOMMENDATIONS

In the future, AID will need to be more selective in how it targets its investments. This will require the development of country strategies with annual funding targets, clearly defined priorities and objectives.

AID should implement a country strategy while still being responsive to host country requests. Being responsive, however, does not mean that AID should become "demand-driven" or allow its contractors to market new initiatives without some guidance. Past experience shows that being reactive and following a "buckshot" approach to identifying projects and firms can lead to disagreement over objectives.

Future areas of AID assistance in all three countries visited should include: additional facilitation of transactions and negotiations work; development of bankruptcy/workout units; more structured on-the-job training with an eye to promoting greater coordination with other donors, particularly PHARE; continued financial sector development and support to mass privatization programs through "back office" support; and, if needed, public information campaigns.

To the greatest extent possible, AID should try to leverage its resources by:

- * Transferring the successful experience in one project from one country to another -- this would be appropriate for the Crimson Capital/D&T work as well as the financial sector development going on in Poland and Hungary,
- * Expanding into new services by building off the experience AID currently has with institutions it is assisting -- e.g. development of workout units in the Czech Savings Bank,
- * Financing small "seed" projects in new experimental privatization methodologies and keeping an out for quickly expanding those projects that look most promising-- e.g. like the Self-Privatization or ESOPs projects and,
- * Working in close coordination with other donors, particularly in the areas of training and high risk areas of assistance like social programs and restructuring.

In the Southern Tier and Baltics --"Stage I" countries -- in which privatization development is not as far along, AID should try to transfer some of the concepts and skills developed in its institutional support and policy/program support initiatives in the Czech Republic, Poland and Hungary.

Specifically, AID should try to achieve the following objectives:

- * **Establish credibility.** Do whatever is necessary to make sure that the country is able to successfully privatize. This could include a "Crimson Capital/D&T" type of assistance to facilitate deals between foreign investors and some of the stronger domestic companies.
- * **Provide consistency.** AID can help develop consistency in the privatization process by establishing institutional procedures and processes. This could be done for both government agencies (e.g. Ministry of Privatization) and private banking organizations (e.g. Czech Savings Bank).
- * **Promote transparency.** AID has extensive experience in helping establish the financial sector and an appropriate regulatory and legal framework. The experience collected to date should be transferred to other countries.

1. INTRODUCTION

Congress passed the SEED Act which authorized and funded AID's involvement with the emerging democracies of Central Europe in late 1989. It was not until late 1990 that AID decided to use an IQC contract (Indefinite Quantity Contract) to manage its Privatization and Enterprise Restructuring Project, Contract 180-0014. In turn, this Contract was not awarded until the summer of 1991, with expenditures charged against it beginning in the fall of 1991 (some work preceded this date).

Under the Contract, 54 privatization projects in eleven countries have been initiated with funds of approximately \$45 million allocated through February, 1993. By March, 1993, these projects have matured sufficiently to evaluate their course and impact. Especially for those in the Czech Republic, Poland, and Hungary, where \$31.3 million, - two-thirds of the total - has been allocated.

The Scope of Work for this evaluation (see Appendix 1) requires "an assessment of the impact and effectiveness of AID's Privatization & Enterprise Restructuring Project (180-0014) in the CSFR (the Czech Republic), Poland and Hungary." Furthermore, this evaluation must "build upon the ongoing, Phase 1 assessment of country privatization programs in these countries under the Price Waterhouse study", Evaluation of Privatization in Central and Eastern Europe, February, 1993.

Paraphrasing the above, the Phase 1 study was to study the wisdom and effectiveness of the privatization programs of the three countries. This successor study reviews the wisdom and effectiveness of the privatization projects that AID and its contractors have executed.

Our study deals with such questions as:

- * How are the projects and AID's overall program to be evaluated?
- * What impact did they have, individually and collectively?
- * Did AID's assistance make a difference, and how much of a difference? What would have happened if it had not been rendered?
- * Is there a coherent strategy underlying the projects?
- * Were the projects: soundly conceived?
executed in a timely manner?
skillfully rendered?
operationally effective and cost effective?
- * Did the projects reasonably follow and accomplish the objectives set for them?

- * What are the preferred programs or projects advisable for the immediate future?
- * What can be learned by AID from these three countries and be applied to other countries in the region, especially in the Southern Tier and the Baltic States?

1.1 Key Issues in Privatization

Experience throughout the world has shown that the presence of political will is the key ingredient in privatization. The countries of Central Europe, especially the three countries considered in this report, are in one sense unique. More than almost any where else in the world - especially outside of Western Europe, North America, and parts of East Asia, most notably Japan - these new democratic governments have turned their backs on the command economies of their past in search of an effective market oriented economy. More than in most other countries, there has emerged a popular will of the people that their governments to do this. Therefore, these governments - however faltering on occasion and with many missteps - have a powerful political mandate to privatize and restructure in order to achieve a free market economy.

Even though the situation in each country is unique, there are common problems to be faced. The road to privatization is always difficult; each country must make critical choices for its privatization program. Some of the common key issues that always have to be faced and the strategy and sequence selections that have to be made are as follows:

Program Objectives: The objective of this evaluation, and that of the privatization assistance that AID renders, is to emphasize economic objectives: for example, will the privatization of a company create new sales and investments that will improve its performance? However, in the real world, governments of privatizing countries must also consider political questions and balance them against economic questions. Often a choice must be made; often political questions dominate an issue. Outside technical assistance does not make the choice between politics and economics; that is for a government to do. But if outside assistance is to be rendered intelligently, it must be sensitive to the fact that such choices exist.

Project Activities: Every privatization program must decide how to distribute its activities. Should it emphasize the development of policies and programs before it builds supporting institutions? Should it focus on transactions or on institution building, or should it alternate its attention and in what sequence? Effective assistance must be aware of these trade-offs. As this report will show, the three countries have made quite different choices in dealing with this issue, and their decisions have taken them down three different paths.

Target Groups: When dealing with firm-specific transactions, what kinds of enterprises should be given priority? Does a country focus its resources on assisting best case "winner" firms, or does it target problematic middle-tier companies that need to be restructured? Does a country approach the privatization of companies individually, or in groups on a sectoral basis? What is the method of selecting individual target companies?

* * * * *

These basic issues, and the degree to which one objective is favored over another, must be faced as part of any privatization strategy. Some of the key strategic questions raised by these trade-offs include:

Type of Strategy: Should a country program develop a cohesive strategy, or should it be ad hoc and flexible in order to respond to a variety of requests?

Type of Sequencing: How should project activities be sequenced? Is it necessary to work on policy reform before firm-specific assistance be provided? Should a program focus on privatizations before, after, or in conjunction with restructuring activities?

This report describes how each of the three countries faced these issues and evaluates the consequences of what they did.

1.2 Overview of AID's Privatization Program in Central Europe

The three summary charts listed below and the detailed charts in Appendix 2 show the distribution of project work for each country.

Total number of projects and funding obligated by country:

	# of Projects	Funding (millions)
Czech Republic	16	\$13.4
Poland	15	10.7
Hungary	13	7.2
<hr/>		
Total	44	\$31.3

Correlating these expenditures with such indicators as population or GNP reveals that the proportion of funds allocated to the Czech Republic and to Hungary are somewhat in balance, whereas the funds for Poland are significantly less. This is largely a reflection of two factors: a) Hungary's privatization program got started first and b) the Czech voucher program, a massive undertaking, has required a major response.

Distribution of projects by type of activity (numbers in millions):

	Policy & Program	Institution Support	Firm-Specific Assistance	Total
Czech Republic	\$1.9	\$7.2	\$4.3	\$13.4
Poland	2.6	0.5	7.6	10.7
Hungary	2.2	4.0	1.0	7.2
	<hr/>	<hr/>	<hr/>	<hr/>
Total	\$6.7	\$11.7	\$12.9	\$31.3

These different activities are discussed in Section 2.1. During the first year of program expenditures in the Czech Republic and Poland, and to a lesser extent in Hungary, AID assistance focused primarily on firm-specific transaction support. In the Czech Republic, the selection of targets was initially quite random. In Poland, the major emphasis was on a sector approach. However, by the end of 1992, AID assistance in all three countries was directed more towards providing institutional support or establishing new policies and programs.

Distribution of work between contractors by country and in total (numbers in millions):

	Czech	Poland	Hungary	Total
Deloitte & Touche	\$7.8	\$2.6	\$5.0	\$15.4
Price Waterhouse	2.0	3.6	-	5.6
KPMG	2.9	3.9	0.3	7.1
Coopers & Lybrand	0.2	0.1	0.8	1.1
Inter-Agency	0.5	0.1	-	0.6
Other	-	0.4	1.1	1.5
	<hr/>	<hr/>	<hr/>	<hr/>
Total	\$13.4	\$10.7	\$7.2	\$31.3

The four principal contractors under the IQC have conducted 90% of the project work. Deloitte & Touche has conducted about half of the work, principally in the Czech Republic and Hungary. KPMG and Price Waterhouse are about even, each almost having half of Deloitte's share, and the others have minor amounts. The method of contractor selection for projects is usually by competitive submissions and based on the client's perceived excellence of the proposal, not by quota or low bid.

1.3 Evaluation Methodology

The evaluation was accomplished by a team of consultants formed by the of joint venture Louis Berger International, Inc./Checchi & Company. Each firm provided two members -- Mr. Paul H. Elicker, Team Leader, Mr. Charles H. Bell, Dr. Allen LeBel, and Mr. Arthur Wielkoszewski. Mr. Bell is an employee of Louis Berger International; the other three are independent subcontractors.

Following preparatory discussions in Washington D.C. with AID officials and contractor home offices, the survey team departed for Central Europe on February 23, 1993 and returned on March 17, 1993, spending a week in each country. Field time was spent interviewing government officials, public and private bankers and officials in privatizing and non-privatized enterprises, as well as other significant players in the privatization process like foreign contractors, lawyers, and representatives of other donors. A list of those interviewed appears as Appendix 3. Field work consisted of visits to the above individuals' various offices and, importantly, to company plant and headquarters locations. Each interviewee had a special point of view toward their experience with privatization, and the survey team purposely contacted a wide variety to get a balanced and rounded point of view.

The local AID representatives and the on site representatives of the four principal contractors were especially helpful in giving their insights and in making appointments. Local facilitators hired in each country on site were also very helpful.

1.4 Structure of the Report

This report follows the broad categories of questions presented in the evaluation scope of work (see Appendix 1). General issues are covered in Section 2, while country-specific issues are presented in Section 3.

Section 2 evaluates the trade offs among the various approaches and the questions raised in the "General Issue" section of the scope of work. Section 3 reviews AID's role in each of the country's privatization programs. This section answers questions raised in the "Country Specific Issues" section of the scope of work as well as reviews the major issues and conclusions presented in the Phase I country assessments carried out by Price Waterhouse.

Section 4 presents a detailed discussion on what the impact of privatization assistance has been and how AID can monitor impact in the future. Finally, Section 5 discusses the general conclusions, lessons learned and recommendations for future activities in each of the three countries visited. It also provides general guidelines to be followed in developing privatization programs in the Southern Tier countries and the Baltics.

2. ALTERNATIVE PRIVATIZATION APPROACHES

2.1 Overview on Four Basic Approaches

The scope of work states that AID has followed four general approaches for carrying out privatization activities. These include assistance:

- 1) at the policy level,
- 2) to public and private entities engaged in facilitating privatization,
- 3) with individual transactions and
- 4) for follow-on enterprise development (monitoring, training, etc.).

This evaluation builds on these approaches and recharacterizes them as follows:

1) Assistance at the Policy/Program Level

This includes general assistance for specified privatization programs including: mass privatization, privatization through restructuring and financial sector reform. The main objectives of this type of assistance are to set up procedures/processes for a new program with many intermediaries (e.g. stock exchange) or to serve as a model for future activities in other institutions (e.g. Czech Savings Bank).

Projects in this category include:

Czech Republic	*	Czech Savings Bank
Poland	*	Privatization through Restructuring
	*	Ancillary Assets
	*	National Investment Fund Support
	*	Banking Regulations
	*	SEC Support
Hungary	*	Financial Sector Reform
	*	ESOP
	*	COMPASS

2) Impact Assistance to Government Agencies

This concentrates on making an individual agency better equipped at handling one activity or a set of activities. This assistance responds affirmatively to the question: "Is the assistance intended to make one agency better at carrying out its objectives?"

Projects in this category included:

Czech Republic	*	Crimson/D&T Assistance to the Ministry of Privatization in the Czech Republic
	*	Price Waterhouse Assistance to the Ministry of Economy for Telecom and Utilities in Czech
Hungary	*	D&T Assistance to the State Property Agency
	*	Assistance to PRI-MAN/ Decentralization project

3) Firm-Specific Assistance

In this category, AID resources are concentrated on assisting firms. Its ultimate objective is to provide resources to one or several firms in an effort to assist them in privatization (e.g. develop financial management systems, privatization plans, etc.).

Projects in this category include:

Czech Republic	*	Skoda-Pilsen
	*	T.A. to five companies (PW--Koli, Holice, etc.)
	*	T.A. to four companies (PW--Ferox, Barandoff etc.)
	*	Assistance to metallurgy firms
Poland	*	Huta Warszawa
	*	LOT Airlines
	*	Glass Sector
	*	Furniture and Particle Board Sector
Hungary	*	Quick Form
	*	Monor State Farm

In all three countries, but especially in Poland, a variation of Firm-Specific Assistance has been utilized called "Sector Assistance". This consists of constructing a privatization plan by systematically considering a whole industry and all of the major participants in it, rather than taking on individual enterprises at random.

4) Training Support

This last category is the most pervasive in the AID portfolio, as well as the most undefined activity. In most projects there is an element of training (e.g. counterpart, seminars, etc.). Typically, training has been viewed as a secondary objective of a larger project. To date, there have been only a few programs that are considered generic management training or privatization training projects.

* * * * *

There is some overlap among these categories. AID work orders tend to contain elements of more than one of these types of assistance. For example, we define assistance for the Czech Savings Bank as "program support" since it is intended to help serve as a model in the implementation of the Czech government's mass privatization program. Others, however, might view such assistance as firm-specific since it is focused on one bank. Similarly, the work of Crimson Capital/D&T on transactions might be viewed as "firm-specific support" since the consultants work on completing transactions with individual companies. But we view it as government agency support since the consultant's primary client is the Ministry of Privatization, not the companies.

As mentioned in Chapter 1, we estimate the distribution of AID assistance by type of activity as follows:

Policy/Program Support	\$6.7 million
Institution Support	\$11.7 million
Firm-Specific Assistance	\$12.9 million

This breakdown was determined by reviewing of the governing PIOTs and the actual nature of the work conducted on site. Our detailed findings are covered in Sections 2.2, 2.3, 2.4 and 2.5.

Each type of assistance can be implemented at one or more stages in the privatization process. Broadly speaking, we have identified three key stages:

Stage I -- "Upstream" Initial Analysis:

During this stage, assistance is focused on identifying privatization constraints and opportunities. At the firm-level, upstream assistance consists of sector studies which review market trends, identify the major companies in the market, and review the overall prospects for privatization. Within government agencies, this assistance typically consists of defining agency roles, structures and processes. "Upstream" policy and program guidance focuses on analyzing institutional, policy and regulatory constraints.

Stage II-- "Midstream" Development of Procedures and Proposals:

The next stage of assistance consists primarily of preparing concrete proposals for privatization (firm-level), institutional responsibilities and flow of activities, and policy/program guidelines.

Stage III--"Downstream" Implementation:

The final stage consists primarily of completing privatization deals and implementing the institutional or policy guidelines defined in Stage II.

As shown in Table 1, much of the AID assistance has been concentrated on "midstream" support to firms, government agencies and programs (\$14.6 million). Equally large amounts of money were spent on "upstream" sectoral studies (\$7.3 million), as well as on "downstream" assistance to both firms and government agencies (\$9.4 million).

2.2 POLICY/PROGRAM SUPPORT

2.2.1 Overall Effectiveness and Impact of Assistance

AID has invested \$6.6 million, or more than 20% of its funds, on policy/program support. Assistance in this area has been spread fairly even among the three countries, with Poland (40%) receiving the most, followed by Hungary (32%) and the Czech Republic (28%).

AID funded assistance at the policy and program level has been found to be cost effective, attractive, and can make a desired impact. If properly executed, policy/program assistance can result in many privatizations, or establish procedures required to maintain an orderly capital market. It is cost effective because often this assistance can be delivered for the cost of privatizing one firm.

Policy/program assistance is attractive since it often provides technical assistance of uniquely American expertise, expertise that the host country prefers to be American, or which is in our best interest that it be American. Its impact, while sometimes difficult to quantitatively measure, is greatly appreciated by government officials and essential to future privatizations.

Among the major lessons learned concerning policy/program assistance are the following:

- * Targeted programs are most successful**

It is most effective when it is targeted and tied to a specific institution or clear objective, as occurred in Poland with the assistance to the SEC and in Hungary with the ESOP project. Indeed good policy/program assistance often resulted in over deliverables and much ad hoc assistance beyond the original scope of work.

- * Advice early in a program cycle helps establish credibility**

Initiating advice early in a program cycle usually creates credibility and can give a jump start to a program. Conversely, late starts often result in picking up the pieces of a failed or ill-conceived program, as is the overall case in Poland. Even a good program, like Hungary's

Table 1 – Matrix of AID Privatization Projects

Stage of Assistance	I Initial Analysis e.g. Sector Studies, Institutional/Policy Analysis		II Development of Procedures and Proposals e.g. Privatization Plan, Definition of Guidelines		III Implementation e.g. Negotiations, New Accounting System
	Type of Assistance				
<div>Phase – Specific Assistance</div> <div>\$12.9 million</div>	P/Glass Sector (#2622122)		C/PW Tech Assist (#1183485) C/Small & Medium T.A. (#1183482, 83, 84, 98)		P/LOT Airlines* (#2622103)
	P/Furniture & Particle Board (#2622121)	C/Util/Telecom* (#1183486)	P/Huta Warszawa (#2622105)		C/Skoda Plzen (#1183489)
	H/State Farms (#2622101)	C/Non – Ferrous Metal* (#2622107)	H/Quick form (#2622115)		
<div>Institutional Support</div> <div>\$11.7 million</div>	P/Task Force Company Assist. (#2622105)		H/Monor State Farm (#1183480)		
			C/Ministry of Economics (#2622125, #1183108)		C/Crimson (#2622108)
			H/Investment Promotion (#2622111)		H/SPA* (#1183482)
<div>Follow Program Support</div> <div>\$6.7 million</div>			P/SEC (#2622113)		H/Self Priv. – Primen (#3622073)
	P/Econ Restruct. & Privatization (#1183478)		P/Privatization through Restructuring (#2622132)		C/Czech Savings Bank* (#2622108)
	P/Tech Studies (#0183478)		P/Ancillary Assets (#2622114)		H/ESOP* (#2622112)
		H/Financial Sector Reform	P/RICS & NIFs (#2622110)		H/Franchising* (#2622135)
		H/COMPASS* (#2622133)	P/Bank Regulations (#2622104)		
	\$7.3 million	\$2.0 million	\$4.4 million	\$6.2 million	\$9.4 million

Legend: C = Czech Republic; P = Poland; H = Hungary; # = PIO/T Work Order
 * These projects were evenly divided between two stages of activities.

Financial Sector Redeployment, suffered when a government official decided to issue his own plan rather than wait for the delayed AID assistance to begin. Much time had to be spent convincing government officials that this plan was inadequate and misfocused before the project could proceed.

*** Programs should be country-specific and managed by the AID field office**

Host government privatization policies and programs are becoming increasingly differentiated, therefore any regional privatization strategy for policies/programs at higher than a country level is inadvisable. In some instances, it is possible to set up a cost sharing arrangement with the recipient of the assistance, as is the case with the Czech Savings Bank.

The AID field office should have the ability to authorize funding of policy/program assistance, and the flexibility to amend authorized funding. The lack of this local authority has constantly held up host country requested assistance.

*** Long term advisors provide needed continuity and flexibility**

Policy/program assistance works well when a long term advisor is assigned to the project and is stationed in country. Such stability is especially significant given the high turnover of personnel in ministries, which has occurred in all countries, particularly in Poland.

Long term advisors can get a handle on the personality and capability of government officials they are supporting, provide continuity when there are changes, and establish credibility for the policy/program. Long term advisors can develop their credibility by providing ad hoc advice, which occurred at the National Bank of Poland when the NBP was faced with its first bank failure crisis. Indeed several recipients of policy/program assistance expressed a desire to have their advisors available for more ad hoc assistance.

The sections that follow provide a brief analysis on policy/program support initiatives in all three countries. Section 2.2.2 provides an overview on the most successful activities by country. Section 2.2.3 focuses on mass privatization issues and compares each country's approach in that area. Section 2.2.4 reviews the problems encountered in trying to develop a program for "privatization through restructuring" in Poland. Section 2.5 then compares each country's efforts to develop appropriate financial sector policies and institutions. Finally Section 2.2.6 reviews other issues and programs in the area including: experimental programs, like "health care" in the Czech Republic, other AID initiatives not financed by the Privatization contract and overall coordination among donors.

2.2.2 Country Overviews

Czech Republic

The Czech Republic is a good example of how the lack of policy/program assistance might end up hindering the overall privatization effort. With the exception of the assistance to the Czech Savings Bank, the Czech Republic has not requested any such assistance, even though the local AID office has met with the appropriate ministries to see if such assistance was required.

For example, the Czech Republic still does not have a functioning stock market or a useful bankruptcy law. Both of these might have been set up by now had AID been able to assist the Czech government on these topics.

Poland

As mentioned earlier, Poland has received the largest amount of policy and program assistance. In part this is due to the large number of policy/program initiatives the Polish government has been willing to develop. AID funded assistance has included: privatization through restructuring program, for spinning off ancillary assets, for corporate accounting and reporting requirements, and for the anti-monopoly commission, as well as for back office support at the MPP and for bank supervision at the National Bank of Poland. With the exception of the first, all of these have proven to be effective and well received.

The only program not discussed below, is the ancillary assets program. This program was successful at fine tuning a large company's plan to privatize ancillary assets (e.g. sports clubs, apartments, kindergartens, etc.). The consultants hired by AID in effect played a validation role for the company. The documentation and manual prepared by the consultants were worthwhile, cost-effective and should help serve as a model for any future ancillary privatizations contemplated by the government and other firms.

Hungary

Policy and program assistance has been less active than in Poland but more so than in the Czech Republic. Still, next to the Poland program, Hungary has experimented with a variety of new program initiatives, most of which have proven to be successful.

AID funded policy/program support initiatives include: 1) initial support to the State Property Agency (SPA) when an AID-funded advisor helped lay out program objectives, 2) development of an Employee Stock Ownership Program (ESOPs), 3) financial sector redeployment, and 4) Consulting of the Office of the Minister for Privatization-Agricultural Sector Support (COMPASS).

Of these, the most successful projects were the ESOPs, discussed below, and financial sector redeployment (see Section 2.2.5 for details).

ESOPs are a tool of privatization which fulfill the host government's desire to give more ownership to workers, yet get rid of the old enterprise (workers') councils. And whereas over 70 countries have some employee ownership legislature, ESOPs are almost a uniquely American idea. Only the U.K. and the U.S. have ESOP legislation, but the U.K.'s is more restrictive and thus less popular.

AID funded assistance was essential to establishing an ESOP law and the technical infrastructure required to make ESOPs work. As a result of this assistance, Hungary is the third country to have an ESOP law, with over 20 companies having achieved approved ESOP status, and over 100 in various stages of adopting an ESOP. Without AID assistance, Hungary would not have any ESOPs. It should be noted that this program was established without any strong advocates within the government, which runs counter to one of our general confusions that the more successful programs have strong government advocates. Rather, the program was approved because it made general political sense.

2.2.3 Mass Privatization

Mass Privatization Programs (MPPs) are an attempt to provide wide ownership of formerly state owned assets to the general public. At the same time, MPPs allow governments to privatize large numbers of enterprises without searching for potential individual buyers, either foreign or domestic. The Czech Republic and Poland have developed their MPPs fundamentally differently, while Hungary is just now considering developing a MPP, with still different features. All three programs are working candidates for assistance and each country's approach reveals the area for AID to tailor its assistance to country specific political issues.

Czech Republic

The Czech MPP was designed to privatize large segments of Czech enterprises quickly and provide ownership in these to Czech citizens. The "first wave" has resulted in 2,000 privatization proposals, out of 8,500 submitted, being approved. A "second wave" is scheduled to review more than 4,500 proposals.

The Czech MPP was designed as a "bottoms up" privatization program whereby all Czech citizens could buy a voucher booklet at a nominal fee, and use the vouchers to buy shares of firms being privatized in the MPP. Mutual funds, called Investment Privatization Funds (IPFs), sprang up, offering extraordinary returns to anyone who traded in their vouchers to the funds.

With the exception of the major training assistance to the Czech Savings Bank, AID has not been involved with any other aspect of the Czech MPP. Evidently the Czech government did request assistance for their MPP, but it appeared that this would interfere with the assistance

already being provided by the British Know How Fund. The request came just before last year's elections and trying to quickly implement it as it was submitted could have created problems. Accordingly this was a good example of when assistance should be denied.

This might be an example of when AID assistance of American expertise could have helped make the MPP more successful, and indeed might even prevent significant problems. For example, although over 1000 firms have been privatized through the vouchers, a functioning Stock Exchange is still not in place.

Additionally, although the mutual funds greatly popularized the voucher program, they do not appear to be adequately supervised. Indeed the government has already taken steps to control them. Likewise, corporate governance issues concerning the newly privatized firms and their new owners do not seem to have been addressed.

Poland

In contrast to the Czech MPP, the Polish MPP is a "top down" approach, whereby about 20 mutual funds are to be established by the government, each primarily responsible for around 30 companies, and having minority interests in some 570 other firms.

The objectives of the Polish MPP are to privatize about 600 middle size companies quickly, provide them with access to foreign capital and foreign technical know how, and give Polish citizens ownership in all 20 diversified portfolios.

The host government's desire to have foreign experts run the investment funds has had a profound effect on the nature of the support work. For example, very little training is required. Also having institutional support for the MPP from the Ministry of Privatization is very important. Ultimately, its success will be measured by the ability of the Western fund managers to raise new capital.

The staff of the Polish MPP is funded by PHARE, while the British Know How Fund, through S.G. Warburg, is providing advice on the mutual funds and the companies. AID is supporting this effort by focusing on back office issues, such as distribution and trading of certificates. This coordinated support allows AID to support a major program at a lower funding level, yet make a profound contribution in shaping the final program.

Accordingly, AID's involvement does not have to be expanded at this time beyond the back office support, since other donors are already supporting other aspects of the MPP. Yet, AID's impact will remain. Going forward, AID's support might evolve toward more of an infrastructure role, like assisting in establishing an OTC market, or towards more of an operational support role. Additionally, once the MPP is implemented and fund managers selected, AID should consider supporting the operations of U.S. fund managers.

This back office project is another good example of how an original scope of work that focused more on providing general advice for what were then called Regulated Investment Funds, evolved so that the fundamentals of an American style capital market could be introduced.

This change might prove critical for Poland. Not only is the American model more attractive to Americans and American institutions - and thus American capital - it is also capable of raising far more fresh capital and handling far more transactions than the continental model for capital markets.

Having a well placed AID funded consultant who is extremely well qualified for this position, proved to be crucial. By advising on the details of a capital market, the consultant was able to steer his counterparts to making necessary policy decisions.

Hungary

Hungary has recently received support from the Know How Fund to study the feasibility of a voucher style MPP, to be called 'credit certificates'. In brief, the program appears to be taking the shape closer to the Czech MPP, except that Hungarian citizens will be required to pay back to the government over long period of time - perhaps 12 years - the funds that they borrowed to buy their vouchers.

Other than through IMPACT, no AID involvement has been requested. It would be beneficial for AID to place a back office advisor in the Hungarian MPP similar to the Polish MPP support.

2.2.4 Privatization through Restructuring

Privatization through Restructuring is a program, only implemented in Poland, that is supposed to assist companies in restructuring before or during the privatization process. At present, the AID project is stalled, an excellent example of how changing host government requirements could not be met by the present set up of controlling the financial decision making in AID/Washington.

Poland initiated its privatization efforts by trying to adopt a sector approach. By reviewing all enterprises within a sector, the government thought it could better understand which firms could readily be privatized, how and for what cost. At the same time, firms would be identified that could be privatized by first restructuring them, whereas others would require privatization through liquidation.

In the capital privatization program, "trade sales" of healthy companies began almost at once, sometimes occurring within the sectorial approach, sometimes outside of it. In an attempt to launch the restructuring program, AID was approached to fund a project that would set up a model for firm restructuring by working with five firms.

From the start, the project ran into trouble. It took about eight months for AID/Washington to approve the project, during which time the Polish Ministry of Privatization requested some changes in the program. This led to disagreement over the objectives of the program with the host government.

The government then set up a parallel project, funded by the World Bank, using a different consulting firm. With competing programs and disagreement over objectives, the host government, in an attempt to get the results it wanted, interfered with the selection process of the enterprises picked to be transformed.

By now, the government only wanted to receive a model contract to offer management firms that would be hired to transform the enterprises. However AID's contractor was unable to fulfil this request because it required a small expenditure (\$20,000) on advertising. In order to spend this money, the contractor has had to get a revision to its PIOT from AID/Washington and receive specific permission for the advertising expenditures. As of this writing, this permission has not yet been received, resulting in a delay of several months and an angry, confused host government.

As a method of privatization, Privatization through Restructuring - along with its companion program, Privatization through Liquidation - seems to us to be an unavoidable necessity. As such, AID should continue to support these programs if asked to do so by the host government. However, it appears to us that both of these privatization methods do not have much political support, or at least there is no political agreement as to what these programs mean. If that is the case, AID should use caution before offering its assistance.

2.2.5 Financial Sector Programs

Banking is a prime candidate for policy/program assistance because of its special characteristic of being central and crucial to the economy. No healthy economy can function without a vibrant banking sector that redistributes a country's savings to those sectors of the economy where they are most needed, and does this transparently.

Unfortunately, under communism, banks were reduced to being mere conduits for implementing the five year plan, without concern for credit risk, market analysis, automation, or customer service. As the countries of Central Europe made the switch to democracy and free markets, their state owned banks were ill-equipped to follow suit.

Not only do the banks suffer from the typical problems of other state enterprises, such as a lack of automation, being undercapitalized and overstaffed, they were stuck with numerous loans that will never be repaid. Dealing with these bad loans looms as a major initiative in itself.

Recapitalizing and restructuring the banks is absolutely mandatory for a country to transition to a free market economy successfully. As such, additional emphasis will have to be placed on the banks in general, and their privatizations in particular.

A major issue in the development of the financial sector is the sequencing problem: Do you first privatize the banks and then make them face up to their bad loans, or vice versa; do you recapitalize the banks directly, or recapitalize the bankrupt firms so that they can pay off their bank debts? There are no easy answers. All that can be done is to experiment with different approaches and monitor which ones work best.

AID is already involved in an indirect way with bank restructuring through its interagency agreement to fund the Treasury Department's assistance to the state banks. Additionally, AID has funded several programs - at least one in each country - under its privatization program. The scope of this report does not cover the Treasury program; only the privatization funded programs were evaluated.

Of special note is the involvement of other donors, in particular PHARE. PHARE wants to be active in bank restructuring, work outs, diagnostic studies, and formal training. It is not interested in new banking initiatives like investments and investment funds.

Czech Republic

Currently, the only bank program in the Czech Republic is with the Czech Savings Bank. Bad loans are a problem that has yet to be addressed. Although the Czech banks are probably in better shape than their Polish and Hungarian counterparts, nonetheless their bad loans should exceed their capital, making them insolvent. Additionally, a bankruptcy law has not yet taken effect and thus bankruptcies have yet to start in large numbers.

AID is funding an extremely well received long term program at the Czech Savings Bank (CSB). Two very senior executives were placed as long term consultants to develop credit risk management, establish a foreign currency capability, restructure internal financial management, and provide technical assistance for implementing the CSB's investment funds for privatization.

The CSB is extremely receptive to the consultants' help, so much so that it has agreed to pick up a sizeable portion of the program's cost. Going forward, it is possible that eventually the entire cost of this program might be borne by the CSB.

Assistance to the CSB was decided upon because of the need for the country's citizens to have confidence in their banking system, the unique role CSB plays in being the depository of over 90% of all private savings with over 2000 offices, and the high level of public confidence that the CSB holds.

Additionally, the CSB has the country's largest investment fund, as over 15% of all vouchers were tendered to it. In the loosely regulated arena of these mutual funds, it is extremely important that this fund be managed properly.

On the other hand, it is hard to recommend that this program be duplicated in other countries. By supporting the CSB, we are in effect helping it perpetuate its monopoly on savings. Furthermore, instead of concentrating on make it function like a Western savings institution, we are moving it into commercial and investment fields. Recognizing that the CSB is a universal bank, it seems nonetheless premature to focus on these new fields and not on its core business.

As an example, while it is true that the CSB has the largest voucher investment fund, in part this might be a result of the CSB's allowing its investment fund members to use their vouchers as collateral for new personal loans. The vouchers have been valued at an assumed book value of the underlying assets of 10,000 crowns, which then can be used to secure a loan of up to 60% of this book value, or 6,000 crowns, whereas the vouchers were purchased for only 1,000 crowns.

Accordingly, although the assistance being provided to the CSB is of the highest caliber and is being very well received, it is difficult to foresee a similar combination of the factors that make this program successful occurring in other countries.

Poland

Poland is be preparing for the restructuring of its financial sector through a systematic approach. Accordingly, financial sector support in Poland involves three successful programs: assisting the National Bank of Poland (NBP) to prepare a bank inspection manual, assisting the Securities Commission to develop reporting requirements, and assisting the Anti-Monopoly Commission.

The NBP is not directly involved in bank privatization as that is the role of the Ministry of Finance as owner of the state banks. Rather, the NBP has an indirect role supervising the banks and maintaining a sound banking system. In particular, the NBP General Inspector of Banking Supervision is concerned that bank privatization maintain the banks' minimum capital adequacy and liquidity ratios after all foreseeable write offs. Accordingly, a program was established to develop a bank monitoring system, documentation and related training.

The NBP feels that the bank inspection manual is the key deliverable. Without AID's assistance, the NBP would not be able to develop this manual. U.S. assistance is especially desired based on the diversified nature of banking in America, including our recent experiences with problem banks. Poland's liberalized bank law permitted many banks to be established prior to the law being changed last year.

The NBP is very satisfied with the assistance it is getting, although it has not yet received the manual. If anything, the NBP would like to use its advisors more on an ad hoc basis, especially as it faces new dilemmas which probably already have precedents in the West. It is especially pleased with the fast reaction time that a consultant on its premises can provide. The NBP feels it needs further assistance in preparing "prudential regulation" on solvency, liquidity, and classifications of and provisions for bad loans.

The programs at the Polish Securities Commission and the Anti-Monopoly Commission have similar characteristics. Both are relatively short term programs, require deliverables in terms of reports or manuals, and have a training component. Both commissions noted the usefulness of a long term advisor and the convenience of obtaining ad hoc advice quickly.

Hungary

Although Hungary created its two-tier banking system in 1987, serious bank reform has only recently been undertaken. As such, Hungary is in dire need of assistance in restructuring and recapitalizing its state banks.

2.2.6 Other Programs and Issues

2.2.6.1 Health Care

In the Czech Republic, a proposed new program will deal with the prospects of privatizing health care. We feel that support for this program needs to be carefully thought out before AID gets more involved with it. First, a significant amount of money will probably have to be spent to reform the Czech health care system, and AID will have to be prepared to allocate these funds if it wants to pursue this new initiative. Second, health care is a particularly sensitive issue with the population, and one for which there might be no easy solution. AID should consider the pay off -or the lack of one - before associating itself with a program that might fail to solve a sensitive problem. Next, health care reform is not a particularly strong American field of expertise. Lastly, the EC apparently wants to approach the health care issue.

2.2.6.2 Other donors

There is no policy or program area where AID is the major donor. Accordingly it is desirable to use AID funding to supplement or complement other donor expenditures, especially for programs that involve American expertise or self interest.

Coordinating AID assistance with other donors is also attractive as all host governments perceive the other donors as requiring their assistance to be tied-in to their special protectionist interests. Host governments perceive AID's assistance to be less restrictive.

The other major donors include EC PHARE, the British Know How Fund, the IFC, the World Bank, the IMF, and the EBRD. The later three operate principally by providing loans

rather than grants, and the IFC operates on a for profit basis. In general, there is little opportunity, nor do we see any reason, to work with these agencies as they do not provide grants.

PHARE was characterized by several sources as being big, broad in scope, and with lots of money, but bureaucratic and slow. By its own admission, PHARE has a problem procuring long term experts. PHARE informed us that they staff governments, like at the Polish Ministry of Privatization's MPP section, and like to concentrate on training. In the future, PHARE expects to be heavily involved with bank workouts.

The British Know How Fund was praised by several sources, and perhaps AID should look at it more closely to see how it operates.

Donor coordination was described to us as being weak and bureaucratically hobbled. Nonetheless, we found several cases of where AID on its own did a good job of coordinating its assistance. For example, in Hungary with the COMPASS program - where parts of the original scope of work were deleted because of PHARE involvement; in the Czech MPP - where AID did not pursue a role because the British Know How Fund was already providing support that was similar to what the host government requested; and in Poland's MPP - where America's expertise in securities operations successfully complements, at a much lower cost, PHARE's financing of the staff and the Know How Funds underwriting S.G. Warburg's large support program.

2.2.6.3 Other AID Projects

Although our Scope of Work was to evaluate specifically the Privatization and Enterprise Restructuring Project (180-0014), some of the General and Country-specific issues required us to review other Economic Restructuring and Private Sector Development projects.

In some instances, we also found an apparent cross over of program support for assistance that might ideally be funded under a different project, as with some of the financial sector programs. We find nothing wrong with this; rather we feel AID funds should be used broadly to support privatization without bureaucratic strict rules for assigning projects to specific funding allocations.

For example, assistance for the Development of Polish Securities Markets and Corporate Governance Structures is provided under Business Services, whereas Polish Securities Commission assistance is part of Privatization and Enterprise Restructuring. Similarly, financial sector support is provided under Business Services - for senior advisors to the Ministry of Finance, the National Bank of Poland, and several state owned banks - and Bank Training, as well as for Bank Regulation and Supervision under Privatization and Enterprise Restructuring.

We feel that the IRIS project in Poland is extremely important, not just for small businesses there but also -and perhaps even more so - for foreign investors, for new private companies and privatized state enterprises regardless of size, as well as for the banks. The IRIS project should be continued until all significant legal and regulatory constraints have been reasonably identified and reform initiated.

Likewise, the work of the IESC, the Business Advisory Service, the Peace Corps, the MBA Enterprise Corps and the GEMINI project seem to us to be very attractive, especially in privatizing small, local enterprises owned by voidvoidships and municipalities, as well as assisting new private entrepreneurs. All of these programs should be expanded and extended so long as the local need for small privatizations remains.

Lastly, we feel that AID will need to concentrate more on the financial sector in the future. In all three countries, we found a growing awareness of the depth and complexity of the issues facing this sector. Significant new programs are required to undertake bad loan work outs and write offs. Donor coordination will be crucial since these programs will be expensive and require several years to implement. Moreover, bank restructuring and a functioning regulated banking infrastructure are required not only for bank privatization, but more importantly for privatization to succeed.

2.3. Assistance to Government Agencies

2.3.1 Overall Effectiveness

AID has invested nearly \$12 million, or about 40% of total privatization funding, in providing assistance to government agencies. About 85% of this has gone towards two institutional support programs -- Crimson Capital/Deloitte & Touche (D&T) assistance to the Ministry of Privatization in the Czech Republic and technical assistance to the State Property Agency (SPA) in Hungary. In addition, small projects have been carried out for the self-privatization and investment promotion programs in Hungary and the Securities Exchange Commission (SEC) in Poland.

With some minor exceptions, these institutional support projects have been successful in facilitating privatizations and, in the case of the SEC project, developing adequate regulatory structures. Perhaps one of the most successful types of institutional support has been the Crimson Capital/D&T support to the creation of a stand-alone foreign investment department in the Ministry of Privatization, precisely targeted as to its function, and filling a needed niche. Less concrete in terms of quantitative impact and more general in the type of assistance has been AID support to the SPA. This project has helped establish AID credibility and leveraging of other donors' assistance. Finally, AID's smaller institutional support projects have helped contribute, albeit in mostly a minor role, to increased privatizations and foreign investment.

The following Sections present an analysis of each of these institutional support programs.

2.3.2 Crimson Capital/Deloitte & Touche

2.3.2.1 Description of Crimson Capital/D&T

Crimson Capital performs one somewhat limited but important function in the investment banking process in the Czech Republic: that of facilitating deals between the Government and an investor in a state owned enterprise (SOE) when it is being privatized.

The Crimson project started operations in August 1990, which is early in the history of Czech privatization. At first, Crimson Capital was a group created as an independent private agency by a sub-contractor of Deloitte & Touche. The subcontractor has departed from the scene and Crimson is now directly subcontracted to Deloitte. Both Crimson Capital and Deloitte & Touche provide assistance to the Department of Foreign Investment in the Ministry of Privatization.

Specifically, the Crimson Capital/D&T group reviews proposed transactions and performs certain steps in the process of closing for each privatization involving outside investment. Almost all of this investment involves foreign investment; about 75% of the transactions in which it participates are those where foreign investment is the controlling partner. It currently employs about 20 Crimson/Deloitte people, the principals being full-time employees hired, many out of retirement, from previous experience with Western investment banking firms.

Crimson Capital/D&T's initial duties were limited to analyzing bids made by prospective investors for privatizing SOEs occasionally seeking out potential bidders from the West. Assumption of these duties occurred just at the time when the privatizations from Czechoslovakia's First Wave Privatization were being processed.

The Crimson Capital/D&T's current duties have been expanded. Its principal function is that of facilitating: bringing buyer and seller together by effecting compromise on terms. For some, but not all proposals, it conducts negotiations on these terms between Government and bidder. It also continues, on occasion, to solicit bids. In all of these duties, it serves as the representative of the Ministry of privatization.

The results of the Crimson Capital/D&T's assistance have been very positive. There have been 63 contracts that have run through the Crimson Capital/D&T group and closed, and there are about 40 more in the pipeline. These represent, at present exchange rates, \$750 million of purchase price and an additional \$930 million of investment commitment. (These figures do not include the three largest privatization-investments, excluded to avoid distortion. Please refer to Section 4 -- Summary on Impact of AID Assistance -- for more details on impact data.)

Without trying to define attribution, it appears that this assistance has been cost-effective. Up through the current expiration date of September, 1993, AID has authorized \$7.0 million for this activity. On that date, the contract will be up for possible extension or possible competitive rebid. The average cost per transaction facilitated is about \$70,000 per transaction fully or partially processed to date. (In citing this figure, it should be emphasized that Crimson does not perform the full investment banking function but only some of the steps in the chain.) If the Czech Government adheres to its present schedule, Crimson expects that its function can be curtailed and handed over to local expertise in the first half of 1994.

2.3.2.2 Analysis of Crimson Capital/D&T

AID's experience with the Crimson Capital/D&T project has been largely positive. It has been high profile, very targeted at the end of the privatization process and has had a large impact that can be quantified (although with many caveats attached-- see Section 4 for details).

The emphasis of Crimson's activities on foreign investments is appealing for several reasons. First, it is an area in which the host government has very little expertise. Secondly, it focuses on a resource base that is crucial to making privatizations successful. Foreign investors bring in new capital, management expertise, technology and access to markets. Thirdly, the project helps to defend the government against political attacks that they are selling off the "state jewels" at a high discount. The Crimson Capital/D&T group has done well at ensuring the government the following benefits: fair purchase price, adequate investment commitment, employment guarantees and resolution of environmental liabilities. Finally, the placement of foreign advisors in the Ministry of Privatization makes it easier for foreigners, particularly American firms, to deal with all the processes and procedures they must follow.

For the most part, the Crimson Capital/D&T group has helped to provide more consistency and credibility to the whole process. While it performs at a stage generally too late in the process to participate in the initial basic fashioning of the deals, it has been able to create a smooth work flow out of what had been a bottleneck. Furthermore, the presence of long term Crimson advisors has helped to provide continuity. This is especially important when turnover in the Ministry of Privatization has been high and foreign investors, complain that other countries with similar high turnover rates but no Crimson group of advisors, result in their having to spend an inordinate time reexplaining proposals to new personnel.

Despite the convergence of all these factors, there are several constraints and weaknesses associated with the program. Conversations with investors, advisors and local companies point out these issues:

- * **Lack of consistent and clear criteria:** The Crimson Capital/D&T group is not always able to close foreign investment deals. Currently, there is a bottleneck in the National Property Fund. Also, some investors and advisors complain that it is not always clear what the final criteria for evaluating the proposal will be.

There are accusations (some of which may be due to the normal course of negotiations) that the terms of agreement are changed late in the negotiations.

- * **Little Impact on "Upstream" and "Downstream" Problems:** The experts in Crimson Capital/D&T and outside investors all point out that the current structure for processing proposals is not always consistent or as efficient as it could be. Often times there are problems that result from intervention by the Founding Ministries and/or the National Property Fund. Since the Crimson group is not place in either organization, it is not always able to resolve potential misunderstandings that arise from agreement terms.
- * **Little Impact on Politicized Deals:** The Crimson Capital/D&T group is not always able to resolve deals that become highly politicized. For example, in Prazska Cukerny, a Czechoslovak sugar company, the combination of a reluctant buyer, poor industry prospects, changing Ministry jurisdictions each with a different outlook, and a shortage of capital and credit have combined to lower each successive bid and make the outlook increasingly hopeless. With an enterprise subject to minimum and declining value and one in which various branches of government are at odds, foreign technical assistance can no longer hope to be successful at present and further involvement should be avoided.

In such poor, deteriorating situations, speed of action to resolve is of the essence. However, without clear authority, neither the Ministry of Privatization, much less the Crimson Capital/D&T group, can be expected to resolve these issues.

- * **Hard to Measure Attribution:** The end results of the Crimson group's efforts are easy to measure-- i.e. deals completed, purchase price, investment committed etc. But the extent to which Crimson's involvement made a difference is subject to varying opinions. At one end, there are those that say that the deals would not have been completed without the assistance of Crimson's support. These advocates point to Poland and Hungary to show how foreign investment deals can easily get politicized and rejected for public fear that foreigners are "taking over" domestic assets. At the other end, there are those that believe such assistance is "useful" but not "critical". These critics point out that foreign investors that who have shown an interest in a deal will do whatever it takes to consummate the deal.

Most likely the truth lies somewhere between the two extremes. At a minimum the presence of a Crimson Capital/D&T serves as an insurance policy to make sure that the government is getting the best deal possible. At its best, the group serves as a focal point from which foreign investments are pushed through an otherwise cumbersome, problematic bureaucratic process.

2.3.2.3 Conclusions on the "Crimson" Program

1. Institutional support programs usually start with an assignment to analyze. Gradually, the contractor, or other performing party, becomes more involved, finds a functional niche for itself, and then disciplines itself to perform in its targeted area.

2. Targeted programs like this can with relative ease develop clear and measurable objectives. In these types of projects the objective is "body count" of privatizations, minimum processing time and cost effectiveness per transaction.

3. Such assistance supplied by foreigners with special expertise is of most help when the target is composed to a significant degree of potential foreign investors.

4. AID's role in this program is important but limited. The alternative to this approach of creating an agency with a targeted objective is to station a full-time advisor in the relevant ministry. This is not necessarily more effective and sometimes it is not wanted by the host government. The task of locating and placing full-time advisors is a critical undertaking. The right man must be found and must be committed for a substantial period of time. This can be expensive.

5. Foreign investors are usually interested in medium-sized or large enterprises, not in very small ones. (This is true even in Pri-Man, which deals primarily with small enterprises.) Smaller enterprises are much more susceptible to domestic purchase, and to MBOs and ESOPs.

6. This type of institutional support typically fills its role very effectively. This is especially the case when working out a deal between a willing seller and a willing buyer.

7. The focus of support when supplying this kind of service is to concentrate primarily on helping the owner, which is the government.

8. Like all sustained programs, this type of support is expensive, but it has a high prospect of success and this being the case, it is cost-effective.

9. Especially as time moves on, the service supplied becomes less and less indispensable as an AID-supplied service. Eventually this service should graduate into cost-sharing and ultimately to a service competently conducted without foreign assistance. In Crimson, the service will become increasingly locally supported and conducted and/or Crimson will run out of work because its task will be completed.

2.3.3 State Property Agency (SPA)

2.3.3.1 Description of the SPA

The State Property Agency (SPA) of Hungary was created in January 1991 to "regulate and encourage" privatization. AID, through another global privatization contract it had with the Center for Privatization, contracted a long term advisor in December 1990 to provide policy and program guidance during establishment of the SPA.

For the period 12/89 to 12/92, AID has spent a total of \$3.8 million on long term technical assistance, short term training, and procurement of equipment and materials for the SPA. The breakdown by category includes:

Long Term Advisor	-- \$0.7 million
Long Term Training Advisor	-- \$0.13 million
Equipment	-- \$0.424 million
Training Programs	-- \$0.9 million
Private Sector Information System	-- \$0.8 million
Compensation Notes Program	-- \$0.36 million
Public Relations	-- \$0.261 million
Project Management	-- \$0.05 million

Support to Other Institutions:

Investment Promotion	-- \$0.165 million
Self-Privatization/Pri-Man	-- \$0.018 million

The assistance to the SPA can be divided into three general phases of implementation. At the outset (1989-90) AID assistance was more focused on policy/program development and institutional support issues. During this time, the long term advisor was involved in developing a strategic plan for the SPA. He, with short term assistance, helped design and present to the government the SPA's operating philosophy, concept pieces on transparency and professionalism, and an assessment on training needs. Especially important during this phase was the establishment of a capability to help coordinate donor aid, particularly from the EC/PHARE program. Also, the contract permitted the team to purchase \$424,000 of computer equipment and software and other office equipment.

During the period 1991-92, AID assistance became more involved in establishing procedures and providing general institutional support. The team helped to establish a comprehensive monitoring system -- "Privatization Information System" -- which tracked all proposals and privatization contracts signed. They also initiated a contract to provide a long term Investment Promotion Advisor who helped coordinate the promotion of foreign investment in the International Trade and Promotion Agency of the Ministry of Privatization.

Finally, during the period 1992-93 AID focused its efforts on providing training, training advisory support and strategic planning for the EC/PHARE training programs. Major activities included: 1) overall training needs assessment, 2) development of training unit policies and procedures manual, 3) establishment of terms of reference for EC PHARE funded short term training consultant, 4) definition of required skills and training responses, 5) organization of training programs.

Besides training initiatives, the SPA assistance also helped finance the development of evaluation criteria for the GOH Self-Privatization program. Deloitte & Touche is developing methodologies for Pri-Man to rank consulting firms interested in managing privatized small/medium-size firms (see Section 2.3.4 for details). Finally, the SPA also used short term advisors to help set up a program for restitution-related compensation notes.

2.3.3.2 Analysis of SPA

The nature of the long term SPA assistance has been different from other institutional support initiatives. Unlike the assistance provided to the Ministry of Privatization in the Czech Republic and to the Securities Exchange Commission in Poland, the SPA assistance has been more general and diverse. On both an ad-hoc and programmed basis, the long term advisor has competently advised and helped build an institutional structure capable of processing privatization proposals. Major tasks, in approximate order of time spent have included: a) development of information systems, b) establishment of operating procedures and processes, c) support for other programs (e.g. Self-Privatization, Investment Promotion), d) procurement of equipment, e) provision of counselling and advice to top and middle management levels and, f) assistance in donor solicitations.

It is difficult to assess the impact of these tasks both because they are so varied and because the effort contributed to a wide range of interrelated institutional processes, rather than a stand-alone intervention. Most measures of success are limited to qualitative statements. For example, all interviewed agreed that the long term advisor and other short term advisors performed their jobs competently. Most of the projects assisted by the team turned out satisfactorily.

Perhaps the most significant achievements of the assistance was that it generated significant goodwill within the government for our aid. The long term advisors assistance helped run interference for the Agency and, in doing so, saved SPA officials a lot of delays and headaches. Furthermore, the advisor provided AID with access by which it could leverage its funds against other donor funds, particularly the EC PHARE.

On the downside, the presence of a long term advisor did not prevent the SPA from becoming politicized. AID assistance helped ensure that the technical review of privatization proposals was done in a consistent, transparent manner. But it did not affect the decision-making process once a proposal went to a final approval committee. Many investors complained that committee review procedures were ad hoc, confidential and subject to many political factors

and considerable delay. High turnover in the SPA often prevented the technical review of proposals from being processed quickly.

2.3.3.3 General Conclusions

AID assistance to the SPA has helped establish credibility with the Government of Hungary, allowed AID to establish itself as a high profile broker of donor assistance and served as a seed fund for other experimental ventures (e.g. self-privatization, investment promotion). This flexibility and long term relationship has helped AID lay the foundation for future assistance. It also has allowed AID, for the most part, to provide timely assistance-- a characteristic that has often been lacking in other countries.

But this general type of institutional assistance has its limitations. First, it is difficult to clearly measure results. By its nature, institutional support of a general type (as opposed to more specific facilitation of privatization negotiations in the Crimson Capital case) can not be directly tied to direct transactions. The only way by which success can be defined is in the quality of the coordination, procedures and processes established.

AID assistance most assuredly helped to make the SPA a well organized institution. It also helped to train a wide range of technical support staff. But it was not designed, nor was it able to resolve political meddling in the privatization review process. During its tenure, many would argue that the privatization process slowed down as the SPA became larger and more developed (as an example they would point to the fact that the SPA staff for facilitating large firm transactions is nearly twice as large as that of Poland which employs 36 people). It would be unfair, however, to try and correlate AID assistance to any perceived slowdowns. Just as it would be difficult to state that AID assistance resulted in a specified number of transactions, so would it be inappropriate to claim that AID assistance helped to create a more bureaucratic institution which resulted in a specified reduction in transactions.

2.3.4 Self-Privatization/Pri-Man Project/Hungary

2.3.4.1 Description of Pri-Man

In September, 1991, the Hungarian government, under the auspices of the State Property Agency, created a new program whose purpose is to speed up and introduce a more domestic orientation into small privatizations. It does this by getting around the legally required bottleneck that the SPA must sign off on all privatizations. It delegates this function to consultants. The name of this program is "self-privatization" or "decentralization". As shown above, AID's assistance to this program has been minimal; but the results of this program look promising and may warrant increased assistance by AID.

The SPA established a wholly owned but separate "subsidiary" -- Pri-Man with a staff of 20 employees -- to supervise all transactions. The reasons why Pri-Man is a separate organization are not entirely clear, but relate to its resulting ability to escape from certain

regulations and from budget and manpower caps applying to SPA, and to Pri-Man's desire in any case to operate independently. This independent subsidiary reviews, selects and supervises the execution of proposals submitted by consulting firms, mostly domestic. The fee payment basis for the consultants is as follows: up until the privatization takes place the enterprise pays the consulting firm. After privatization takes place, payment is only on a "success fee" basis at 5% to 8% of the purchase price.

Since the establishment of Pri-Man, AID's role in developing the institution has been limited. Initially, Deloitte & Touche was hired by SPA to carry out certain limited tasks, some of them relating to equipment and systems procurement. D & T was late securing authorization to act, however, and was not able to deliver on its equipment assignment. In the meantime, Pri-Man was able to begin operations without assistance. Consequently, D&T's role has been limited to providing assistance in evaluating consulting firms that wish to bid on firms.

The development of evaluation criteria is important for ensuring that Pri-Man contracts with reliable consulting firms. There have been as high as 132 consulting firms on the list, almost all of them domestic, but this list is now reduced to 84 firms. 35 of them are judged as performing satisfactorily. All the others are facing some problems, primarily regarding their stated capabilities. Consultants have been inclined to exaggerate their skills and many are weak in completing valuations.

From the outset the demand and results of the program have been impressive. 700 SOEs wanting to privatize joined this program voluntarily. At first the only eligible companies were small ones with sales not over \$3.5 million a year, later this was raised to \$12.5 million; there are also other restrictions as to maximum size. To date, Pri-Man has completed 100 privatizations. The principal elements of another 220 are known and it can be assumed these also will go through. The average purchase price for the completed deals is \$50,000.

Pri-Man is chartered for existence until March, 1995, by which time it expects to have processed about 1000 enterprises and its job will then be completed.

2.3.4.2 Analysis and Conclusions for Self-Privatization/Pri-Man

AID had an early involvement in this program, but does not yet have a heavy involvement in this program. Allocated funds, which are under the long term advisor umbrella, are something less than \$200,000. There was considerable AID procedural delay in getting started and perhaps as a consequence, AID's role today is somewhat secondary.

Perhaps as a result of authorization delays for D&T's assistance in procuring computer hardware and its own high self-esteem, Pri-Man does not rate Deloitte & Touche input as particularly significant. Still, according to Pri-Man's chief executive, Pri-Man "needs help, but he is too busy to analyze what help is needed"!

The principal stumbling block in this Self-Privatization program so far has been the capability of the consultants and low bidding prices for firms. Less than half of the approved list are judged as competent. An estimate of all the privatizations processed through consultants so far is that about 25% of the privatizations were technically to be judged as "good" jobs, 50% as "acceptable", and 25% as deficient. It is clear that there is a learning curve and that consultant capability must be raised. Also, there is a perceived need to try and raise the bid levels of consulting firms. In Pri-Man's judgment, there have been many bids received for their client privatizing enterprises but they have all tended to be low.

The Self-Privatization program is experimental and if it proves to be successful, there may be a third wave of the program. The primary future challenges faced by the program, and ones in which AID assistance may be productive include:

- * It is anticipated that many of these newly-privatized companies will go bankrupt. There is still no plan for dealing with these and other companies outside the program that go bankrupt.
- * There remains the disposition of the SOEs that do not volunteer for the Self-Privatization program. They will be dealt with later, perhaps by changing the General Managers of these enterprises.

2.3.5 Securities Exchange Commission/Poland

AID provided a little less than \$500,000 for technical assistance to the Securities Exchange Commission in Poland. Most of this assistance was conventional in that it consisted of seminars, development of reporting formats and a manual for following reporting requirements. Still, it was considered very useful by the SEC client and a good niche in which the U.S. had a comparative advantage.

The main task requested by the Polish Securities Commission was the preparation of reporting requirements for all newly listed Polish public companies. Additionally, the consultants helped to prepare a manual listing these reporting guidelines and provided training to financial managers and accountants within the commission and in the public companies. A total of 20 personnel received training in the commission and an additional 40-50 from public companies.

Without AID's assistance the Commission felt that neither the reporting requirements, the manual nor the training could have been adequately prepared or conducted, since such expertise does not exist in Poland. Other donors could not be responsive to the Commission since none had a program which could adequately meet the Commission's needs in a timely manner and since the U.S. provides the model for a stock exchange regulatory body.

2.4 Assistance to Individual Enterprises

This section reviews AID assistance in firm-specific privatization transactions. Assistance to large firms, and especially the limitations of this kind of support, are discussed first in Section 2.4.1. The same is then done in Section 2.4.2 for small and medium-sized firms looking at a couple of government-sponsored approaches, including the "sectoral approach" described in Section 2.4.3. Section 2.4.4 then covers some special considerations regarding foreign investments. Finally, Section 2.4.5 gives some general remarks on the problems associated with AID's administration of firm-specific assistance.

2.4.1. Assistance to Individual Enterprises - Large Firms

2.4.1.1 Overall Effectiveness

Much of AID's initial firm-specific investments focused on large firms. Beginning at the end of 1991, a total of \$2.8 million was spent on five large firms: Huta Warszawa, LOT Airlines, Sandomierz Glass, Monor State Farm and Skoda-Pilsen. (In addition, three large firms under the jurisdiction of Crimson Capital show a similar profile and are discussed in Section 2.3.1.)

To date, assistance to large individual enterprises has not generally been successful in bringing about privatization promptly and cost-effectively. However, despite the overall inconclusive outcome in such complex undertakings, AID-sponsored facilitation between the parties and its role in negotiation has been effectively performed.

A person considering in the abstract the likelihood of success of different kinds of technical assistance in privatization might well conclude that assistance in individual company transactions would have the greatest likelihood of success. Such assignments would be material, ones that one could "get one's teeth into", dealing with tangible company problems rather than with the vague concepts of assistance to policies, programs, or governmental institutions.

Investigation of the facts shows the exact opposite to be the case.

Of these five large firms assisted by AID, none have been privatized. For one, the prospects of privatization soon are good. Three of the other four are disasters, with each of them in or near bankruptcy. These results are not very good, particularly when it is considered that most of the assignments to work with these institutions began some time ago, early in the country programs.

Assistance to large companies has not resulted in consummated deals, but even if they had been successfully privatized, this type of assistance would not have been a cost-effective route to privatization. It is difficult to estimate the cost of successful privatizations when so few of them have yet been brought to conclusion. General estimates put the cost of any of these sizeable privatizations to be somewhere well over \$500,000 each, with as per the above, nearly that much cost accumulating even for unsuccessful privatizations.

In most cases, privatizations of large enterprises are almost invariably slow in being consummated. Invariably, these enterprise situations and the problems that surround them are numerous and complex. The more they are top down, government-initiated, the more this is the case.

2.4.1.2 Complicating Factors in Large Firm Privatizations

1. As always, the principal impediment to success in large company assistance is the absence of political will.

- * In Skoda-Pilsen, the overhanging fear of the loss of 35,000 jobs has induced a paralysis to action.

- * In Huta Warszawa, there was general uncertainty as to whether and under what circumstances foreign acquisition should be permitted.

- * In Monor State Farms, a change in law and policies, combined with an emerging fear of foreign takeover, has caused a scrapping of privatization plans and led to bankruptcy for this formerly healthy enterprise.

2. Assistance to individual enterprises will always be ineffective in the presence of poor management.

- * The three companies mentioned above had incompetent management for an extended period of time.

3. In privatization assignments with large enterprises, some restructuring is almost always necessary. Especially when this is attempted before privatization, accomplishing this successfully under Government management is dubious of success.

4. Large firm privatizations seem to be inherently complex undertakings. These large enterprises are frequently conglomerate in nature and there is usually the need to split the enterprise into several pieces, often into many separate entities. These entities will have different objectives and different strategic considerations. Powerful political forces relating to these key enterprises will be impacting the government. Numerous players from different jurisdictions are involved: government, the enterprise and prospective buyers, with a host of advisors to each. The usual presence of foreign participants adds to the difficulties of cultural interface. The procedure for required tenders is complicated.

- * There are about five other SOEs like Skoda-Pilsen in the Czech economy, at least several of them in the same kind of trouble as is the case with Skoda-Pilsen.

- * In the privatization of Sandomierz, a Polish glass company, and the sale of majority ownership to Pilkington Glass, there is joint financing by several participants, heavy

additional investment required, many government ministries involved, and various changes in capitalization as the plans evolved.

There are certain enterprises where the complexities are so considerable that no amount of assistance, regardless of how skillfully pursued, can hope for success. In such poor, deteriorating situations, speed of action to resolve is of the essence.

5. A great many privatization projects, especially those that are large and troubled individual transactions, are taken on because the host government, having an urgent problem, requests help. After all, the reasoning goes, we want to be responsive to host government needs as they perceive them. We do have to do some of this. It should be recognized, however, that the call for help in a damaged situation is rarely successful.

* In Hungary, the First Privatization Program selected 20 enterprises in early 1990 at the inception of the Government's privatization program. The objective was that these would be privatized by 1991. Only three of the companies were ever privatized, all of them very late to schedule. A more specialized Second Privatization Program met a similar fate and a Third Privatization Program never got off the ground.

2.4.1.3 Role of AID Assistance

There are two roles in which AID can be most useful. One is in "facilitating" processes and procedures needed to make companies pass through the various founding ministries and the Ministry of Privatization. Another is in "negotiating" final deals with foreign investors.

In complex, large firm transactions, there is a role, and an important role for a facilitator: one who stands between the various parties and represents each to the other. This is a valuable and important role and one that AID and its contractors have frequently filled very well. See Section 2.3.1 for discussion of Crimson Capital in Czechoslovakia and assistance to the Self-Privatization Program Hungary. The contractor in the role of facilitator has always been viewed, favorably, by the various parties as being the representative of the Ministry of Privatization or sometimes the founding Ministry.

* In LOT, the Polish airline, the engagement took on many aspects, but the initial work was that of facilitating between the enterprise and the Ministry of Transportation.

Also, in deals involving foreign investors AID has played an active role in advising host governments. This is especially useful when: 1) there is a negotiating committee representing the various interests and, 2) where enterprise location is geographically removed from the seat of the government and its various departments.

Another important role is that of the "negotiator". Typical negotiating issues have been: valuation, a projected production program, an investment and construction program, price, commitments on maintenance of employment, and environmental liability. Beyond price, the

principal government preoccupations have been maintenance of employment, investment commitment, and environmental liability, perhaps in that order.

AID assistance in both negotiations and facilitation is most critical during the early history of a privatization program. However, both the roles of "facilitator" and "negotiator" become less important as time goes by. Increasingly, it is possible for government itself to fulfill the facilitating and especially the negotiating roles. For example, while AID assistance in foreign investment negotiations was very important to facilitating deals; the Czech Republic is now arriving at the stage where foreign assistance can and will decrease and be replaced by domestic assistance.

2.4.2. Assistance to Individual Enterprises - Small and Medium Firms

2.4.2.1 Overall Effectiveness

Similar to assistance to large enterprise transactions, privatization assistance to small and medium-sized enterprises has not been very cost-effective either. This approach has usually been too imprecisely targeted or arbitrarily targeted based on political considerations.

In total, AID has worked with a large number of small and medium firms in the three countries. The most popular approaches for targeting firms can be characterized as follows:

- * **"Buckshot" Approach:** This occurs when firms are randomly selected by contractors seeking to provide assistance or by governments that select firms for targeted assistance, often on the basis of political considerations.
- * **Sector Approach:** This approach has been most popular in Poland. For each sector the Government selects a consulting firm to analyze the sector and select a "short list" of firms for more specialized assistance.

Each of the above approaches has been affected by one or both of the following problems. First, the random or arbitrary selection of firms results in technical assistance being spent on problematic, in some cases, least attractive firms. In the absence of strong management commitment, such an allocation of funds can easily be dissipated. Another problem is that there often is not enough money to assist a firm from the beginning (e.g. preparation of a privatization plan) to the end (e.g. negotiating a deal). Like the larger individual transactions for privatization, these smaller ones are not particularly cost effective. They are not subject to the same degree of complication as the larger transactions; still the steps in individual transactions, even when their smaller size simplifies them, all take a certain unavoidable minimum amount of time.

The weaknesses, with examples of the "buckshot" approach is discussed in greater detail below. Insights on the sector approach are presented in Section 2.4.3.

2.4.2.2 Complicating Factors in "Buckshot" Approach

The "buckshot" approach to privatization, used more frequently with small and medium-sized firms, is one where the universe from which enterprises to be considered for privatization is selected out at random-- either by contractors or governments-- without regard to probable success or significance. This selection usually takes the form of a list of privatization candidates being arbitrarily composed, sometimes with investigation as to privatization probability of each enterprise as a second step.

This approach is typical of approaches to country privatization programs when they are in their early stages. Almost by definition, their "hit record" in identifying a solid privatization prospect has a low success ratio.

Experience shows that when governments pick out the candidate targets for privatization, they prove not to be very good at it. This is because the government has a great many other considerations on its mind, many of them political. As one example, they tend not to pick out prospects likely to succeed in privatization, but conversely are prone to unload their "problem" enterprises.

- * KPMG's assignment in the Czech metallurgical industry: The assignment was characterized by a random selection of this industry by the Government on personal rather than strategic grounds and a random selection of three firms in the industry ranging from one with good prospects to one with poor prospects. The key is this random selection of enterprises; it suffers from the same disadvantages as those discussed above.

In other cases, contracting firms were given authority to look for promising candidates to assist. This was often done during the early stages of privatization when governments and AID were interested in getting privatization off to a "flying start". Contractors were granted a sum of money and told to locate privatization candidates to fill in their allotment. Some successful privatizations were executed, but whether they were worth doing, especially for the money involved, is a good question. But many of these arbitrary candidates were never privatized at all. Some of them didn't at the time want to privatize.

- * In Czechoslovakia, Price Waterhouse located a small film company, Barrandov, and assisted its management group's in the development of a privatization plan. While competitors had access to the same data prepared by PW, all other bids, with the exception of the management group, were unresponsive. Full success for the winning management group depends on a related future real estate venture. Meantime, financing of the takeover of the present enterprise was facilitated by liberal terms permitting payment for the present business to be made out of projected future earnings.

This experience raises the question of whether AID money, especially in privatization's more mature stages, should be used in transactions with preferential financing or where there is profit that is not preceded by investment is open to question.

* The Czech and Slovak American Enterprise Fund pursued in their earlier days something of the same approach of money being allocated which then went looking for candidates. There is somewhat more reason for this in the case of the Funds, since it is their role to use their funds to foster small enterprise and stake it to achieving an eventual return. Still, early attempts at finding "winners" quickly ran into political obstacles that made each of the initial interventions unsuccessful.

Even when attractive candidates were selected, it is then open to discussion whether AID money should be used for privatizations that might take place in any case. For the most part, AID's role in assisting small/medium enterprises is sandwiched between troubled enterprises whose privatization it should avoid financing and those attractive enterprises that will attract investor attention in any case.

* The two top members of management of Krakzklo, a medium-sized enterprise that is Poland's largest manufacturer and distributor of mirrors, have been participating in the steps leading up to the privatization of the enterprise. They know that the decision on the new owner will be made soon and as between two applicants. They have no idea which one will be selected and have not been consulted as to their opinion. They prepared on request a memorandum on desirable terms but they do not know the price offers or any other contract commitment requirements decreed by the Government or what are the offers made by the two prospective acquirers. They understand the Government's attitude to be that it, after all, is the owner and can therefore sell its property as it wishes.

A final issue concerning assistance to small/medium enterprises is the lack of communication between government agencies and the companies. The larger transactions involve a great deal of interchange between a large number of persons as the complications of a transaction unfold. By contrast, the smaller enterprises seem to be kept much more in the dark by their "owners" (the state) as to progress on the privatization of their employing entity.

[Note: We have been asked to comment on Truehand, the German privatization agency that represents an alternative approach for both large and small companies, but especially small ones. Comment is contained in Appendix 4.]

2.4.3 The Sectoral Approach

The Sectoral Approach, which takes on privatization for the enterprises in an entire industry, suffers from the same disadvantages as taking on transactions individually. It may ultimately prove to have merit, but so far it can only be recognized as expensive.

2.4.3.1. Description and Rationale

The Sectoral Approach is a method of privatization that has only been employed to any substantial degree in Poland. It involves the following features:

- * An industry, or industries, are selected and data is assembled as to the enterprises composing its important participants.
- * Profiles are drawn up on the industry in general and on a substantial number of the individual enterprise participants. The industry profile is designed to reveal the major factors for success in that industry.
- * Enterprises are selected for privatization priority. This priority is based principally on deciding which enterprises are the most likely to appeal to prospective investors, principally foreign, but also domestic.
- * Privatization then proceeds on an individual transaction basis.

To date, 35 industries have been identified in Poland as subject to this approach and about 20 have been let out by bid to privatization advisor companies, mostly foreign. These 20 are in varying stages of completion of a sectoral study. The glass industry, awarded to Price Waterhouse, was the first sector assignment to an AID contractor and is overall the farthest along. We visited two companies in this industry and two included in a separate Study by KPMG of the furniture and particle board industry. To date, only privatizations out of a total of 54 case-by-case privatizations have been effected through sectoral studies. We know of four in the detergent industry and three in the pulp and paper industry and believe that is all so far.

The rationale behind this approach is based on the beliefs that:

- A wiser disposition of the industry can be made if its total configuration is understood.
- As a result, a pattern can be set for the industry so that in the latter stages one-by-one transactions can be speeded up.

2.4.3.2. Cost-effectiveness

These concepts may ultimately prove to have some validity. This has not been the case yet. Perhaps there has not yet been enough time, although the project has been long-standing. Experience so far is that the Sectoral Approach is subject to some of the same problems of cost effectiveness that have affected the Individual Transactions route. There is inefficiency in considering a group of candidates for privatization many of whom prove not to be well adapted to it at present. There is actually additional up front time required to first assemble the industry profile.

Above all, investment banking, which is the nature of these transactions, is inherently expensive. It is hard to estimate costs per transaction in the middle of the sectoral process before it is known how many transactions are going to fall out from the work done in common on the industry. Our rough estimate of the number of privatizations that will result in the Glass and in the Furniture industries without further significant expenditure by AID is about five in each of these industries. If so, the cost per transaction would be about \$600,000, about the same as our previously estimated minimum of S 500,000 for individual transactions. Depending on the consultancy cost in the detergent and pulp and paper industries, which is not known to us, the cost per transaction there may have been somewhat less.

We have identified that the main component contributing to a cost higher than desired occurs at the front end. It just has taken too long to survey the industry and get down to the stage of preparation of the individual prospects for privatization. In the case of the glass industry, this phase took over six months. It was anticipated that experience would permit this industry analysis phase to be reduced, and in the Furniture Sector it was reduced to about three months. Nevertheless, the overall cost per transaction was still high. We believe a reasonable objective for the industry analysis phase is no more than two months.

As with the Individual Transaction approach, having government indicate the candidates for examination proves unreliable.

2.4.3.3 A pilot operation

There has been one engagement in Hungary that we have classified as both a "large firm-specific approach" and a "Sectoral Approach". This is the assistance given to Monor State Farms. The sector is Agriculture, more particularly that portion of agriculture represented by some 120 state farm SOEs. The particular aspect of this assignment that is of interest is that it approaches the industry by having selected one enterprise as a pilot case.

* Monor State Farm was selected as representative of this somewhat more homogeneous industry category. Monor, typical of state farms, is engaged in farming and animal husbandry, but also in a variety of other agribusiness activities. Agriculture is an important and potentially world competitive Hungarian industry. It seemed particularly important to construct a new privatization pattern to take the place of the established practice of "czak soport", a form of joint-venture subsidiary spinoff that siphoned off parent enterprise profits and was rife with graft and abuse. Monor was an enterprise that particularly wanted to privatize and it was hand-selected by the SPA and the Ministry of Agriculture.

Despite the fact that no privatization resulted, there is no reason to fault its original selection as a target. Monor had the usual complex and convoluted history typical in such cases (further reference to this is in Section 3.4.1 of this report). In the end, privatization probably could have occurred if prompt execution could have taken place before various political and management failures intervened. AID delayed work authorization for completion and Monor's

involuntary bankruptcy under the Bankruptcy Law of April, 1992 was the final straw that scared off investors. Monor is no longer recoupable as a privatization candidate. The cost to AID was about \$250,000 and is estimated at \$100,000 more had privatization been completed.

In the Monor case, the contractor was able to get a prompt start despite the delay in authorizing the IQC procurements, because work could be early authorized under an existing agricultural authorization.

2.4.4 Foreign Investment

2.4.4.1. Potential Services for Facilitating Foreign Investment

Foreign investment, of course, is principally related to transactions: a potential investor is attracted to an enterprise that may be available for some transfer of ownership and his interest is such that he proceeds, step by step, to be involved in an investment possibility.

There are various stages in the foreign investment process where a potential investor can receive assistance. These include:

1. The service of locating the investor in the first place as a likely prospect.
2. Providing the potential investor with factual, financial, and statistical data on the prospect enterprise, packaged attractively, and in a format with which he is familiar. In many initial instances, contractor personnel have prepared the country's initial information memoranda.
3. Providing a physical locale, perhaps under Embassy jurisdiction, that can serve as a geographic contact point.
4. Acquainting the prospective investor with the legal and procedural requirements of the host government and identifying the governmental and other principal players with whom contact is required. Locating other specialized advisory help, legal council familiar with local requirements, for example.
5. Serving as a go-between with all the opposing parties at interest -- i.e. serve as the "facilitator" among government agencies and targeted domestic companies.
6. Helping to resolve differences between the parties: the negotiating function.
7. Seeing the process through to closure.

In each of these areas, AID and other donors can be of special help. Particularly in Central and Eastern Europe, the provision of these services by foreign consultants can be useful in understanding what investors need and presenting information to investors in a familiar form.

AID assistance in these areas can be useful from both the host government point of view and from the point of view of the US economy.

2.4.4.2. AID-Financed Investment Services

Of the three countries, only one, Hungary, has set up a special investment advisory service for potential foreign investors that has expatriate staffing. It is part of a section first created in the Foreign Affairs Ministry. Staffing financed by AID consists of one expatriate individual. In fact, the job was tailored to the special capabilities of the individual who happened to be available and may not be renewed now that his service period has expired.

Besides this service, AID assistance to foreign investors under the privatization contract has been indirect, focusing on assistance to governments. Projects like the Crimson Capital/D&T and firm-specific assistance to LOT airlines require constant interaction with foreign investors. In each case, however, the main client of these services is the host country government. Still, foreign investors benefit as a result of the increased transparency, more consistent technical standards that the foreign advisors provide to governments.

2.4.4.3. Issues Pertaining to Foreign Investment

One of the most pervasive problems concerning foreign investment is the often misguided public perception that foreign investment will "takeover" the country or "steal" the country's assets. This all-too-common phenomenon is present in each country in varying degree. Whatever its degree of intensity, it is always tempered to some extent by the urgent fiscal and investment needs of each country and the lack of sufficient domestic resources to fill the need. Both management and labor in each of the three countries recognize the benefits associated with foreign investment: new technology, but capital needs, know-how, especially marketing know-how, and access to hard currency customers.

It is interesting that the country that first went the farthest in encouraging foreign investment and in making it a substantial reality, Hungary, is now the country having the most severe backlash on the issue of "selling out the country to foreigners". The backlash is, of course, political in origin. Several of Hungary's recent investment promotion initiatives, notably the Self-Privatization program, are constructed so that domestic investment will be further encouraged and accommodated. In Poland and in the Czech Republic, privatization contains a provision for employee ownership (20% and 10% respectively) that among other purposes increases the domestic ownership component.

Given these positive contributions, it is advisable to promote both foreign and domestic investment. It also would be advisable to develop, where possible, public awareness programs. To date, only one country (Rumania, outside the immediate scope of this report) has a PIOT for a public awareness program. While such a program may not have as its basic motivation a

rebuttal to the "foreign takeover" issue, it can play an important role to accustoming the public to foreign investment.

2.4.5 Overall Administration of Firm-Specific Transactions

Despite the overall low cost-effectiveness of small/medium size transactions, in all three countries, recipient firms (and government officials as well) gave substantial praise to the expertise of AID consultants' work and the professionalism with which it was executed. Only in Poland was this mixed with some complaints about the caliber of the consultants' work.

One of the biggest issues that arose in implementing firm-specific assistance was the overall administration of the scopes of work. Too often there were disagreements or misunderstandings between the AID/representative, AID/Washington and/or the Contractor. In every case we inspected, when differences as to the scope of work developed in the minds of the various parties, the assignment produced less effective results.

- * There was an instance of a contractor intra-jurisdictional dispute that the Government felt shut off control over the work that they felt they legitimately should possess.

- * There was the question of differences of interpretation of scope on some projects, with local consultants, local AID, AID/Washington and host government officials each sharing in creating some of these differences.

- * There was one case where a final report was rendered to the subject company only in English.

- * And lastly, there were the many instances of late starting due to late authorization referred to before. This does not relate to the caliber of the work, but unlike the Czech Republic and Hungary, AID assistance got off to a slow, and therefore a bad start in Poland. This undermined credibility generally and probably contributed to the negative attitude present in some quarters.

- * In Huta Warszawa, the steel company in Poland, the need for the valuation work requested to be timely was especially urgent because it was tied to acquisition negotiations that were proceeding rapidly. Several delay factors combined: the effectiveness of the new IQC contracts, jurisdictional confusion within the contractor's shop and arbitrary de facto changes in the scope of work caused the enterprise to reject some of the work and to conclude that, "standby agreements are subject to at least as much delay as tenders".

If, as we understand has been subject to some discussion, a new mechanism to replace the IQC is intended, it is absolutely vital to the effectiveness and credibility of US aid that there be provision assuring that there will be no delay gap again.

Finally, the question has been raised whether privatization should be AID financed and pursued when the jurisdiction over an SOE is at less than the federal level (or in the case of Czechoslovakia below the Czech Republic level.) Except for the above remarks about lessened cost-effectiveness at a local level that features mostly smaller enterprises, there is no reason why there should be any other difference in eligibility for AID support. In fact, two-thirds of all the number of SOEs in Poland are at the decentralized administrative district level (called vovoidships). Therefore, some involvement at the local level is inevitable at least in Poland. Also, many of the municipal service activities are governed at this level and experience elsewhere indicates that these are important candidates for privatization.

2.5 Assistance in Monitoring and Training

2.5.1 Summary of Section

The AID portfolio of privatization projects has no direct training projects. There are, however, a few large projects that could be considered to be predominantly training vehicles. For example, both the assistance to fund managers in the Czech Savings Bank and the assistance to Hungary's State Property Agency all have a heavy emphasis on training. Still, most of the training in the portfolio is an ad hoc conveyance by counterparts who provide on-the-job training in the course of their other duties.

In the future, AID should follow a more structured approach to on-the-job training as well as training in certain specialized areas such as bankruptcy workouts and financial sector policy. It should also look to leverage its programs by working closely with formal training programs being developed by PHARE. Finally, it should develop a monitoring system which will allow it to better identify training needs and track the results of training activities.

2.5.2 Amounts and Types of Assistance Rendered

Training activities account for 16%, or just under \$5 million, of the total \$31.3 million authorized for privatization activities. This total does not include the learning that takes place on an indirect basis whenever one person communicates with another in a project.

Most of this money is spent for training, with little spent on monitoring. With the exception of the SPA project in Hungary, there is no program for following up and monitoring training activities or newly privatized companies. There is, therefore, no system for determining post-privatization results of AID projects.

Table 2 shows, by PIOT, the kind of training assistance that has been provided to date. A quick review points out that:

- * Training within government agencies has been ad hoc and mostly conveyed through counterpart advisors. Only the SPA in Hungary has a systematic program with some structure to it.
- * Formal training plans do not exist except in the SPA,
- * Worker job descriptions were not found at any of the projects,
- * No monitoring or evaluation of training has occurred except in the SPA project, and
- * No incentive systems were found that reward training performance.

Table 2 does not reflect any training that might take place in companies. Nevertheless, there are two kinds of training that take place within SOEs or privatized SOEs. First, there are those companies that receive training on Western management as a result of a sale or joint-venture partnership. This training is, necessarily, job training and is directed toward the new enterprise's specific needs and goals. A second type of training is indirect and might take place as a result of AID or other donor assistance in sector studies or firm-specific assistance. Unfortunately, this type of training, albeit indirect and not an intended objective, is the only form of training received by firms that do not have direct access to foreign partners.

2.5.3 Training Assistance by Country

Czech Republic

There are only two projects that have any direct or indirect training.

- * The Crimson Capital/D&T involves some on-the-job training. Training beneficiaries include locals who have been hired by Crimson, various Government officials that have taken part in a deal, principally in the Ministry of Privatization, and the managers of the companies being privatized. With all these people, however, it is uncertain to what extent their is long-lasting knowledge transfer.
- * A more purposeful source of training has occurred in the Czech Savings Bank. Training is currently being given in four functional areas in the CSB. But only training related to the creation and operation of the investment funds is considered part of privatization work. This training is partly classroom and partly counterpart training, or unstructured on-the-job training.

TABLE 2.1
INVENTORY OF MAIN TRAINING ACTIVITIES

COUNTRY/PROJECT	TYPES OF TRAINING:	Formal Courses		Internship	Study Tours	Seminars/Conferences	Workshops	Counterpart Training	On-Job Training
		Off-Job	On-Job						
		< 6 wks	> 6 wks	1-6 Months		1 to 3 Weeks	1-2 day program	(Ad Hoc Q/T)	Or Planned
A. CZECH REPUBLIC									
1. Crimson Capital Technical Assistance (#2622100)									
a. Ministry of Privatization (CMOP)									
b. National Property Fund (NPF)									
i. Backlog of Transactions									
ii. Post-Transaction Role									
c. Founder Ministry									
d. Office of Economic Competition									
e. Economic Council									
2. Czech Savings Bank (CSB) (#2622108)									
a. Creation of Investment Funds									
i. Corporate Governance									
b. Credit Risk Management									
c. Process International Transactions									
d. Internal Financial Management									
3. Skoda-Pilsen (Restructuring) (#1183489)									
4. Barrandov Film Studios (Management buyout) (#1183485)									
5. Kovohute Rokycany (#2622107)									
6. Other									
a. Corporate Governance									
b. Bankruptcy Legislation									
B. POLAND									
1. Bank Regulation & Supervision (#2622104)									
a. Bank Inspection Manual (70% of total effort)									
b. New Regulation Implementation									
2. Huta Warszawa Business Valuation (#2622105)									
3. Antimonopoly Office (Interagency effort)									
4. TA to Polish Securities Commission (#2622113)									
a. Train Commission Staff									
b. Train listed Companies									
c. Train Companies to be listed									
5. Lot Privatization & Partnership (#2622103)									
6. Privatizing Ancillary Assets (#2622114)									
7. Privatization through Restructuring (#2622132)									
8. TA for Mass Privatization (#2622110-120)									
a. System									
b. Supervisory Boards of Mutual Funds									
c. Supervisory Boards of Companies									
9. Economic Restructuring and Privatization Process (#1183476)									
10. Privatization of Polish Furniture Sector (#2622121)									
C. HUNGARY									
1. TA-State Property Agency (SPA) (#1183482)									
2. TA-Investment & Trade Promotion Agency (#2622111)									
3. TA-Redeploy Financial Assets at Banks (#13622071)									
Currently in Phase I, training to be specified in subsequent phases									
4. Privatize Small/Medium Firms ("Quick Form") (#2622115)									
No Training Specified									
5. Agricultural Sector Support (COMPASS) (#2622133)									
No Training Specified									
6. TA to Privatize through Employee Ownership (#2622112)									
7. Monitor State Farm Preparation for Privatization (#1183480)									

= PIO/T Work Order

TABLE 2.2
TYPES OF MONITORING AND EVALUATION METHODS

COUNTRY/PROJECT	MONITORING METHODS:				EVALUATION METHODS:					
	Schedule Conformance to Training Plan	Attendance %	Training Plan	TA Years	Participant Appraisal	Supervisor Appraisal	Measure Job Skills Change	Training Unit Staff	(Written) Job Descriptions	Incentive System for Training
A. CZECH REPUBLIC										
1. Crimson Capital Technical Assistance (#2622100)										
a. Ministry of Privatization (CMOP)										
b. National Property Fund (NPF)										
i. Backlog of Transactions										
ii. Post-Transaction Role										
c. Founder Ministry										
d. Office of Economic Competition										
e. Economic Council										
2. Czech Savings Bank (CSB) (#2622108)										
a. Creation of Investment Funds										
i. Corporate Governance										
ii. Credit Risk Management										
c. Process International Transactions										
d. Internal Financial Management										
3. Skoda-Pilsen (Restructuring) (#1183480)										
4. Barrandov Film Studios (Management buyout) (#1183485)										
5. Kovohute Rokycany (#2622107)										
6. Other										
a. Corporate Governance										
b. Bankruptcy Legislation										
B. POLAND										
1. Bank Regulation & Supervision (#2622104)										
a. Bank Inspection Manual (70% of total effort)	X		-				X			
b. New Regulation Implementation	X		-				X			
2. Huta Warszawa Business Valuation (#2622105)										
3. Antimonopoly Office (Interagency effort)	-	-		2/Calendar Year	-	-				
4. TA to Polish Securities Commission (#2622113)				320 Days						
a. Train Commission Staff										
b. Train listed Companies										
c. Train Companies to be listed										
5. Lot Privatization & Partnership (#2622103)				320 Days						
6. Privatizing Ancillary Assets (#2622114)										
7. Privatization through Restructuring (#2622132)				300 Days						
8. TA for Mass Privatization (#2622110-120)										
a. System										
b. Supervisory Boards of Mutual Funds										
c. Supervisory Boards of Companies										
9. Economic Restructuring and Privatization Process (#1183478)	X	X			X					
10. Privatization of Polish Furniture Sector (#2622121)										
C. HUNGARY										
1. TA-State Property Agency (SPA) (#1183482)	X	X	X	3-4	X	X	-	1 Full-Time		none
2. TA-Investment & Trade Promotion Agency (#2622111)				Part of 1 a						
3. TA-Redeploy Financial Assets at Banks (#13622071)										
Currently in Phase I, training to be specified in subsequent phases.										
4. Privatize Small/Medium Firms ("Quick Form") (#2622115)										
No Training Specified										
5. Agricultural Sector Support (COMPASS) (#2622133)										
No Training Specified										
6. TA to Privatize through Employee Ownership (#2622112)				X						
7. Monitor State Farm Preparation for Privatization (#1183480)										

= PIO/T Work Order

TABLE 2.3
EVALUATION TEAM RECOMMENDATIONS

A. CZECH REPUBLIC

1. Crimson Capital Technical Assistance (#2622100)	
a. Ministry of Privatization (CMOP)	
b. National Property Fund (NPF)	
i. Backlog of Transactions	
ii. Post-Transaction Role	
c. Founder Ministry	
d. Office of Economic Competition	
e. Economic Council	
2. Czech Savings Bank (CSB) (#2622102)	
a. Creation of Investment Funds	
i. Corporate Governance	
b. Credit Risk Management	
c. Process International Transactions	
d. Internal Financial Management	
3. Skoda-Pilsen (Restructuring) (#1183489)	
4. Barrandov Film Studios (Management buyout) (#1183485)	
5. Kovohute Rokycany (#2622107)	
6. Other	
a. Corporate Governance	
b. Bankruptcy Legislation	

Training should be structured rather than unplanned

Needs TA structured to complement Crimsons's work in CMOP to close deals faster.

Needs TA structured to complement Crimsons's work in CMOP to close deals faster.

Needs TA structured to complement Crimsons's work in CMOP to close deals faster.

Needs a complete workplan including training.

Not a training target

A training plan should be derived from a yet-to-be developed plan for the structure and operation of CSB's investment funds.

A training plan is needed for investment fund and company boards

CSB will soon have an inherent conflict of interest as both creditor of and new owner of firms through its mutual funds; hence new management systems and training related to privatization are needed.

Privatization will increase international transactions, and private owners will demand efficiency adding to urgency of training.

CSB will soon have an inherent conflict of interest as both creditor of and new owner of firms through its mutual funds; hence new management systems and training related to privatization are needed

Project is completed; training was a minor component.

Project is completed; management bought firm.

Project completed; no joint venture partner yet; to be privatized in Wave II

Judges and bank officials need training.

B. POLAND

1. Bank Regulation & Supervision (#2622104)	
a. Bank Inspection Manual (70% of total effort)	
b. New Regulation Implementation	
2. Huta Warszawa Business Valuation (#2622105)	
3. Antimonopoly Office (Interagency effort)	
4. TA to Polish Securities Commission (#2622113)	
a. Train Commission Staff	
b. Train listed Companies	
c. Train Companies to be listed	
5. Lot Privatization & Partnership (#2622103)	
6. Privatizing Ancillary Assets (#2622114)	
7. Privatization through Restructuring (#2622132)	
8. TA for Mass Privatization (#2622110-120)	
a. System	
b. Supervisory Boards of Mutual Funds	
c. Supervisory Boards of Companies	
9. Economic Restructuring and Privatization Process (#1183478)	
10. Privatization of Polish Furniture Sector (#2622121)	

Establish plan to train trainers and other staff
Establish plan to train trainers and other staff

Develop training plan with case studies to train trainers

Consolidate training plan to permit analytic review
Develop an M&E plan based on current train trainer plan

A plan is needed to formally document training.

Structure the experiment within a training plan

The project and resulting management contracts could have training plans

A training plan is needed to implement the system.

This effort created an initial awareness in the Ministry of Privatization of training uses

Have a training plan to upgrade local skills systematically

C. HUNGARY

1. TA-State Property Agency (SPA) (#1183482)	
2. TA-Investment & Trade Promotion Agency (#2622111)	
3. TA-Redeploy Financial Assets at Banks (#3622071)	
Currently in Phase I, training to be specified subsequent phases.	
4. Privatize Small/Medium Firms ("Quick Form") (#2622115)	
No Training Specified	
5. Agricultural Sector Support (COMPASS) (#2622133)	
No Training Specified	
6. TA to Privatize through Employee Ownership (#2622112)	
7. Monor State Farm Preparation for Privatization (#1183480)	
# = PIQ/T Work Order	

Continue OJT orientation, focusing on Structured OJT

Project completed tasks in SOW related to training implementation through trained trainers, seminars & manuals; independently operating ESOP consultants confirms project effectiveness

Poland

Training in Poland has involved:

- * Technical assistance for mass privatization has, like its counterpart in the Czech Savings Bank, a training emphasis. It differs only in that it is not as precisely focused since it covers a variety of the "back office" operations necessary to make the National Investment Funds (NIFs) function.
- * KPMG is working with the Bank of Poland on a Bank Supervision Manual. When finished, this manual will be a training document aimed at regulating and restructuring banks.
- * Technical assistance to the Polish Securities Commission involved a series of formal classroom seminars for officials of the Commission and of the 17 companies listed on the Warsaw Stock Exchange. This training focused on internal accounting at the Exchange, Exchange reporting and public company reporting. An end objective is to develop a manual that can be used for future training.
- * It should be noted that the Phase I work, completed in connection with the Sector studies, represents another kind of job-related, training on the subject of analytical company assessments. Since the recommendation is made elsewhere in this report that sector studies not be pursued further, this form of access to training is not recommended.

Hungary

Activities in Hungary that involve training include:

- * The work begun on Phase II of the financial sector redeployment project to restructure public sector debt,
- * Development of methodologies for the non-cash sale of relatively less profitable companies to be privatized, and the development of a department within the SPA to utilize these methodologies on a sectoral basis,
- * The training work under a skilled training supervisor that is taking place as part of the SPA project. Even if the advisory part of this work is discontinued in September, 1993, the training component and the training supervisor should be continued under local SPA supervision. At such time as the SPA is terminated, this training function could be transferred either to AVRT or it could be phased into PHARE's work.
- * Institutionalization and implementation of a new ESOP law

2.5.4. Impact and Results

It is difficult to monitor the impact of training, even when it is done in a structured manner with clearly defined objectives. Even more difficult is trying to measure the impact and results from indirect, on-the-job training.

Training to date has focused on privatization and private sector support institutions: securities exchanges, ministries of privatization, and banking and legal institutions. Virtually no training has occurred in privatized companies themselves, except through foreign owners or partners. Areas in which training has occurred include the facilitation of investment banking functions, credit analysis, environmental liability, ESOP and other legal regulations related to commercial law.

In general, the strongest training in all three countries came from a long term advisor working in the policy/program or institutional support areas. The SPA project, in particular, had the most structured, complete and probably most effective training. AID assistance, combined with PHARE funding, has resulted in more than 600 people being trained. Some of the areas in which training has been carried out includes: environmental liability, commercial law, negotiation skills, export marketing, investment promotion, trade development, general management skills, computer skills, secretarial skills and bankruptcy management.

Both the supervisors and those trained in the SPA state that they prefer on-the-job training. The supervisors believe that most workers are too busy to take time out for any other kind of training. Low attendance (67%) at five day off-site courses confirms this view. By contrast, job-related, two-day workshops that use one day of a weekend resulted in 100% worker attendance. Job-related working meetings at lunch also result in high attendance ratings.

Besides the SPA, conversations with people that have indirectly received training by working with long term advisors shows inconclusive impact. These trainees say that their experiences have been valuable, but it is doubtful that they are capable of carrying out any of the tasks performed by the advisors.

2.5.5 General Conclusions and Recommendations

Future training should stress structured on the job training (OJT). It should also try to address some of the major skills gaps that, in the absence of training, could easily slow or jeopardize the privatization process. These include: bankruptcy and workout analysis in the banks, marketing and accounting in firms, corporate governance, and the continued management of investment funds.

AID assistance should focus on training public officials to manage the privatization process; rather than trying to target individual firms or spread its resources too thinly among the private sector. Where possible, AID should try to leverage its help in these areas by working more closely with the PHARE and other donors with greater training resources. Finally, it will

be important to establish more effective follow-on monitoring activities that provide insights into training needs and overall project impacts (see Section 4.2 for more details).

1. Structured On-the-Job Training

It will be important to reorient existing on-the-job training so that it is more structured. "Structured on-the-job training" is a common term in the world of training. It is a system of training whereby the specific curriculum, the use of the curriculum, and the responsibilities of trainees and trainers are fully specified together with monitoring and evaluation criteria before the training occurs. Appendix 5, "A Proposed Framework for Structuring, Delivering and Managing Structured On-the-Job Training", provides details on this approach.

The greatest risk associated with structured OTJ training is that the long term technical advisors will not want to implement it. It is estimated that this approach might occupy between 5% and 30% of the technical advisor's time. Advisors typically like to advise, not train. If the structured approach does occupy more of the advisor's time, it may require more advisors to complete the necessary advisory and training tasks. In any case, it might be necessary to hire skilled trainers to train the technical advisors in training.

2. Bankruptcy and Workouts

Another new subject that should be taken up as a training topic is the forthcoming emphasis on bankruptcy regulation and the related subject of work-outs. This work, however, cannot begin until a complete government policy on bankruptcy becomes law.

3. Corporate Governance and Management Skills Training

The privatized companies, especially those not associated with a foreign investor, need training in a number of subjects that can be summarized as corporate governance and skills training, particularly in the areas of marketing and accounting. Some of this may be conveyed through the boards of directors that emerge in the Czech Republic, although these boards are not likely to have had experience running companies. If the mass privatization program eventually emerges in Poland, and it does so in its proposed form, those funds will be composed of foreign fund managers who will hopefully possess corporate governance skill.

Nevertheless, training in corporate governance or skills for individual companies remains an unsolved problem, but, due to its scale and complexity, can only be addressed by AID on a strictly experimental basis. There is also the possibility of merging the effort with proposed PHARE training programs for enterprises.

4. Off the Job Classroom Training

Off-the-job classroom training should be continued for special purposes. Short-term legal training and secretarial courses in the USA, for example, are very popular in the SPA. It will

continue to occupy a supplementary role to structured OJT and should be handled through its own administrative system if the period of training exceeds six weeks. This topic is addressed in Annex 1.

5. Follow On Monitoring System

AID, in coordination with other donors, should develop an effective follow-on system that will identify manpower shortages and surpluses at the firm level. Such a system could also be used to monitor the impact of privatization assistance (e.g. number of workers trained, types of training carried out). Once needs are identified, perhaps through the reporting systems that USAID is developing for the securities exchanges, training packages can be developed.

6. Leveraging of AID Training Resources

Leveraging would involve sharing the training task with other donors such as PHARE and accomplishing the task with organizations such as the International Executive Service Corps, MBA Enterprise Corps, and the Peace Corps Free-Enterprise Transition Consortium.

2.5.5. Country Specific Conclusions and Recommendations

Czech Republic

1. Examine ways to expand training programs into the National Property Fund, the Founder Ministries, and the Office of Economic Competition. Training for the National Property Fund is particularly important because a) it has a backlog of privatization projects to complete and b) as owner of many firms it must develop monitoring activities to exercise its responsibilities as a caretaker of these firms. This type of training should only be done if it receives the full support of the NPF.
2. Develop a project to restructure the debt of the banks and SOE's. Such a program should probably be housed in the Central Bank with linkages at the Cabinet level to the Ministries of Finance, Privatization, and other relevant Ministries. It should include a structured OJT training component.
3. Continue training in the Czech Savings Bank for the management of investment funds. Such training, however, should be more structured and not as open-ended as it has been in the past.
4. Develop a regular reporting system for public companies. Reporting data could be specified which would help determine if companies that do not have joint venture partners need marketing assistance or help with credit or training. This reporting system could also be used to determine if joint venture partners are keeping their contractual commitments to their local partners.

Poland

1. Develop a more structured training program built around the Bank Supervision Manual. AID should try to establish a program to train trainers to (a) teach external bank examiners how to use the Bank Supervision Manual and to (b) teach bank staff how to respond to new ad hoc regulations issued by the Central Bank.
2. Continue more structured on-the-job training for technical assistance for mass privatization program. If enabling legislation is passed, a more structured approach might require new counterpart staff in sufficient numbers for the counterparts to provide the required training.
3. Modify the public company reporting system that is being developed in the Polish Securities Commission to that it can be used to develop a monitoring program for privatized companies. The reporting data could help to identify training needs of companies, and the extent to which joint venture partners are meeting their contractual commitments.

Hungary

1. In concert with PHARE, develop a structured on-the-job training program to strengthen the training by counterparts and to expand into needed new training areas.
2. Expand training programs for later phases of KPMG's advisory work restructuring debt in the public sector banks.

3. COUNTRY SPECIFIC ASSESSMENTS

3.1 Overview

Each of the three countries in which AID privatization assistance was evaluated has followed distinct paths. As shown in the table below, the Czech Republic and Hungary have emphasized institution support, while Poland has focused its efforts more on firm-specific assistance and sector studies.

	Policy & Program	Institution Support	Firm-Specific Transactions	Total
Czech Republic	\$1.9	\$7.2	\$4.3	\$13.4
Poland	\$2.6	\$0.5	\$7.6	\$10.7
Hungary	\$2.1	\$4.0	\$1.1	\$7.2
Total	<u>\$6.7</u>	<u>\$11.7</u>	<u>\$12.9</u>	<u>\$31.3</u>

While some similarities exist, the overriding lesson learned from this evaluation and previous ones (e.g. Price Waterhouse) is that the privatization process (and AID assistance) has to be reviewed in the context of country-specific constraints and opportunities. This involves taking into consideration political and economic factors. It also requires looking at the evolution of privatization policies and programs, rather than taking a snapshot and reviewing a program at one particular point.

In the sections below, we analyze the distribution of AID program activities in the Czech Republic (Section 3.2), Poland (Section 3.3) and Hungary (Section 3.4). We also review how this assistance fits into the overall country strategy as described by previous evaluations (mainly the Phase I country assessments) and findings during this evaluation. Finally, each country review includes a summary of future issues that should be considered in the course of developing new programs and implementation strategies.

3.2 Czech Republic

3.2.1 Distribution of Program Activities

Since August 1991 AID has financed a total of 16 projects or work orders totalling (in obligated funds) \$13.4 million dollars. The breakdown of these projects by type of assistance is:

Policy/Program Support	\$1.9 (14%)
Institutional Support	\$7.2 (54%)
Firm-Specific Assistance	\$4.3 (32%)

Total:	\$13.4

Early on, the emphasis of AID program was evenly divided between assistance to companies and assistance to government institutions. Most of the 1991 work orders focused on the execution of sector studies or the development of privatization plans for individual companies. Concurrently, there was a dramatic increase in funding for Crimson Capital/D&T to assist the Ministry of Privatization in negotiating trade sales with foreign investors.

By 1992 the program developed new programs in support of mass privatization and the financial sector. This was primarily executed through one institution, the Czech Savings Bank. Assistance to individual companies was curtailed, while continuing support was provided to the Ministry of Privatization through Crimson Capital/D&T.

Overall, AID spent more than half its funds on institutional support, primarily through the efforts of Crimson Capital/D&T. This was similar to the distribution of investment in Hungary, an significantly above that spent on institutional support in Poland (5%). The early emphasis on assisting companies resulted in about one-third of total expenditures being spend on firm-specific assistance. This is significantly above that spent in Hungary (15%) but also well below what Poland spent on firm-specific assistance (71%).

3.2.2 Comparison with Phase I Country Assessment Conclusions

The Czech Republic's privatization strategy has followed the most decentralized, "bottom up" approach of the three countries visited. Strong presidential authority has allowed the Czech government to encourage laissez-faire, relatively unregulated privatizations to take place.

The more salient characteristics of this approach confirmed by both the Phase I country assessments and this evaluation include:

- * **Rapid Development of Privatization Plans:** SOEs were responsible for preparing privatization plans by October 1991. During this stage, the government encouraged competition by accepting proposals from all interested parties -- management, employees, outside buyers. In most cases, however, the management's proposal was the found to be the most acceptable.

The Founding Ministry then approved these plans, usually not paying much attention to the quality (e.g. business/market analysis, proposed reorganizations) of the analysis. Once approved, the plan then went to the Ministry of Privatization which decided on the type of privatization.

- * **Promotion of Market Driven, Decentralized, Unregulated Mass Privatization Program:** The Czech Government developed a voucher program which gave "free" (except for an administrative charge equal to 25% of 1 month's salary) vouchers to all Czech citizens. These vouchers could be freely "invested" individual companies or in Investment Privatization Funds (of which more than 400 were formed). The development of vouchers and investment funds was rapid and involved the public early on.
- * **Promotion of Foreign Investment in the Privatization Programs:** The Czech government has openly encouraged and facilitated foreign ownership (mostly majority) in the privatized companies.

The results of this strategy have been impressive -- at least on the surface. Through mid-January of 1993, the Ministry of Privatization had evaluated nearly 8,600 of the roughly 11,300 privatization projects submitted in the first wave, of which 2,000 have been approved. Most of these privatizations were part of the voucher mass privatization program. Today, nearly three-quarters of all eligible citizens have participated. In terms of foreign investment, there are 220 under negotiation, with 63 having been approved (see Section 4 on the results of the Crimson Capital/D&T project) amounting to revenue and new investment of more than \$1.6 billion.

A major issue associated with the Czech program, however, is the quality of the privatizations. A privatization by legal transformation does not necessarily mean that there will be a significant change in ownership or a capability to reposition a company. There is very little attention paid to the possibility that vouchers could lead to a highly dispersed ownership of enterprises and the absence of a major shareholder in a position to influence enterprise policy.

Also, there is a legitimate question as to the social and economic equity of the mass privatization program. Many of the better companies found foreign partners before the vouchers were issued. Therefore, the remaining companies available for voucher "investments" are highly risky and subject to future bankruptcy. In the absence of prudential regulation, investment funds could corner large blocks of vouchers. Also, the existing institutional structures for managing the Investment Privatization Funds (IPFs) are inadequate. In short, the assumption of "let the buyer beware" may lead to significant political and economic fallout once it becomes clear which companies are viable or bankrupt, and once the market determines which IPFs are competently managed and which are not.

Finally, it is uncertain what will happen to companies that are not privatized or cannot survive the implementation of a new bankruptcy law. Currently, the law states that all transformed companies are transferred to the National Property Fund. However, it can take the NPF up to 5 years to privatize. The NPF's policy to "privatize not administer" means that there will be a long period of weak governance. Furthermore, in the absence of a single dominant and active shareholder, many of the companies in the Investment Privatization Funds (IPFs) will likely go bankrupt and have to be liquidated or restructured. Currently, there is no government assistance in place to respond to these demands.

3.2.3 AID's Role in the Privatization Process

In the Czech Republic, AID has not had to worry about developing a political consensus for privatization. Still, it has rightfully had to help guard against the political fallout that can come from implementing a rapid, relatively unregulated privatization program. Also, in the case of individual company assistance, it is clear that political factors have intervened (e.g. selection of companies, purchase price recommendations) which have slowed and made company-specific assistance relatively ineffective.

From the outset, AID was able to develop a responsive and timely assistance program. This was in large part due to the fact that a senior manager from AID/Washington was in the Czech Republic when initial assistance needs were being formulated. Upon her return to Washington, this manager was able to quickly push the proposed projects through approval process. This was unique to the Czech Republic and was important to establishing AID credibility with the Government. (Unlike the case in Poland where initial delays proved to be highly damaging to the credibility of AID. See Section 3.3 for details).

In 1991 AID assistance followed a "buckshot" firm-specific approach that emphasized assistance to individual firms or to sector studies with the objective of developing individual privatization strategies. Most of this assistance took place in 1991 and was initiated through the marketing efforts of individual Contractors.

As mentioned in Section 2.4, most of this assistance has been unable to achieve its primary objective-- privatization. This is due to a number of conditions. First, individual company assistance is easily complicated by a number of factors: different end objectives, reluctant buyer or seller, poor prospects, changing government jurisdiction, shortage of credit and equivocal attitude of government. In the case of Skoda Pilsen, individual assistance was made ineffective by the presence of poor management and government indecisiveness. In the sector studies, it was found that strategic studies concentrated too many resources "upstream" identifying winners and not allowing for enough resources to complete deals.

Beginning in 1992, however, AID has shifted away from assisting individual firms, to focusing more on assisting institutions -- public and private -- involved in "facilitating" the privatization process. The two primary recipients of AID resources have been the Ministry of Privatization and the Czech Savings Bank.

In both programs, AID has successfully supported "facilitator" activities. In the Ministry of Privatization, Crimson Capital/D&T have focused assistance on assisting the MOP to negotiate deals with foreign buyers. The MOP work has helped the government gain better benefits in terms of: purchase price, investment, environmental obligations and employment guarantees. The assistance has helped saved money and processing time. Also, according to interviews with foreign investors, the presence of foreign advisors in the ministry has provided continuity where ministries have suffered from high turnover. Finally, in the public's eye, the

negotiating process has protected the Czech government from accusations of "selling the family jewels" at an undervalued price.

In the Czech Savings Bank, KPMG advisors have helped train managers for the investment funds. This assistance will help ensure that the leading fund in the voucher program will be able to handle the responsibilities and protect investor interests competently. This assistance has been worthwhile because: it is central to the economy and to government privatization strategy, the CSB has significant funds, the CSB plays an important role in the voucher program, and CSB has high public trust.

Both programs have helped the Czech government to establish credibility and consistency in the management of its privatization program. This is particularly important early in a privatization program when new approaches are being tested and public trust is tenuous. The success of both programs is due to several contributing factors: 1) clearly defined activities and narrow focus, 2) strong government support, 3) not having to analyze, screen and select "winners", 4) providing help "downstream" in the privatization process (e.g. after firms have found foreign partners, or managing existing investments) rather than "upstream" (e.g. carrying out initial market or sector studies), and 5) adequate coordination between AID/Washington and the AID representative in the Czech Republic.

3.2.4 Future Issues

The challenge for future AID assistance will be in helping the Czech government make the transition to the next stage of privatization. To date, assistance has helped in facilitating the processing and management of firms that have "self-selected" themselves to be participants in the privatization program.

In the coming years, AID assistance will have to focus increasingly on helping the Czech government manage the "losers" and/or the struggling "middle tier" firms in the privatization transition. There are many firms in the Czech economy that are not attractive to foreign buyers, nor do they currently have the existing capability to remain profitable. In the absence of debt renegotiation, restructuring or management assistance, many of these firms will fall victims to a new bankruptcy law likely to be implemented this year. In the face of these hardships, public support for the program might waver and actually turn against the government's privatization programs.

Specific issues that have been mentioned in the evaluation scope of work and commented on by government and private officials are presented below.

1. Development of Voucher Program and Capital Markets

AID should continue to support the voucher program by providing assistance to the Investment Privatization Funds (IPFs). To date, AID assistance has primarily has been focused on the Czech Savings Bank, one of the largest fund managers.

In the future, AID should look to spin off any training programs it develops in the Czech Savings Bank to other holding companies. In this way, AID will avoid being accused of favoring only one institution. Such assistance, however, should be selective and focused on the institutions that are best able to effectively utilize the assistance.

A related issue to the voucher program is the development of capital markets. There are many projects initiated in Poland that should be considered for financing in the Czech Republic. Some of the more important would include: development of regulatory framework, anti-monopoly assistance, establishment of a SEC reporting system. As mentioned earlier, one of the biggest challenges that the Czech Republic will face will be in regulating and managing the political risks associated with rapidly growing voucher trading.

2. Complementarity and Transferability of the Voucher Program

AID's focus on facilitating foreign investments through the Crimson Capital/D&T project as well as assisting the voucher program through one institution is well founded. The program is soundly balanced between foreign and domestic investment, thereby protecting itself from accusations that it is unfairly favoring the promotion of foreign investments at the expense of ignoring the development of domestic privatizations.

Just as the Czech Republic can and should draw upon the lessons learned from Poland in terms of establishing a regulated capital market framework, certain elements of the Czech voucher program can and should probably be transferred to other countries, most notably Hungary, the Southern Tier and Baltics (Poland already has its own mass privatization program under development). The major lesson learned from the Czech experience is the need to balance "supply side" development of the program-- i.e. concerning the quantity and quality of submitted privatization projects -- with "demand side" issues like establishing regulations for Investment Funds and developing sound institutional structures.

3. Foreign Investment Disincentives

Conversations with foreign investors did not reveal the lack of clear tax liabilities as being a major disincentive. Rather it was the time involved in clearly defining environmental liabilities and other representations and warranties that most preoccupied foreign investors. Along these lines, there was general frustration that even with the Crimson Capital/D&T the process at times tended to be time consuming and full of complications involving many government agencies. (It should be noted, however, that most investors agreed that without AID assistance the processing time would have been even longer and more problematic). As evidence of this institutional bottleneck, it has been pointed out that out of 202 negotiations with foreign investors, only 63 have been closed.

It is unclear whether future foreign investment will be deterred by a lack of investment incentives or an overall lack of attractive investment opportunities. As foreign investment interest declines, AID might consider developing (either in the privatization contract or some

other contract) an aggressive, targeted investment promotion program. Such a program would combine work on the policy front with institutional support for investor outreach services.

In general, however, given the magnitude of domestic and regulatory issues that will most likely affect the Czech privatization program, additional assistance in foreign investment should be considered secondary to those programs focused on supporting mass privatization and the development of bankruptcy/workout assistance programs.

4. Managing the Fallout from Privatizations

Throughout the region, a major challenge will be in managing the adverse consequences of bankruptcies resulting from privatizations and declining government support for enterprises.

AID has considered and should focus on the following: 1) helping the banks to develop "workout" units that can work directly with adversely affected firms, and assisting the National Property Fund in managing its assets (contingent, of course, on the NPF demonstrating an interest in receiving assistance).

Unfortunately, there is very little experience in the region from which to draw on in the design of these programs. None of the countries visited has implemented and, equally important, enforced a bankruptcy law. (Hungary implemented legislation, but has not effectively enforced it). Consequently, none of the countries has had to resolve the consequences resulting from enforcing bankruptcy legislation. All this suggests that AID should move quickly in developing experimental programs in each country, all the while trying to learn from each country's experience so that the positive elements of one program can possibly be transferred to another country. Of course, any lessons learned should be tailored to the country-specific constraints and opportunities concerning institutional capabilities, political support and the stage of privatization.

5. Other Issues

The AID office in the Czech Republic is considering a program to help privatize the health sector. As mentioned in Section 2.2, there are several issues concerning the implementation of such a program. First, it will probably take a significant amount of money which AID may not have. Secondly, the reform of health care, as evidenced by the U.S. experience to date, is complicated and full of political and social ramifications. It is unclear whether the Czech government will have the willpower to follow through on such a program. All these factors suggest that AID should seek to develop a consensus among the donor community so that it does not become the primary source of funding. Also it should proceed carefully, making sure that there is strong political support for any new initiatives.

3.3 Poland

3.3.1 Distribution of Program Activities

Since 1990, AID has financed a total of 13 projects or work orders totalling \$10.66 million. The breakdown of these projects (in millions) by type of assistance is:

Policy/Program Support	\$2.6 (24%)
Institutional Support	\$0.5 (5%)
Firm-Specific Assistance	\$7.6 (71%)

Total:	\$10.7

On a per capita basis, Poland has received a disproportionate small amount of AID assistance for Privatization and Enterprise Restructuring. With a population of approximately 39 million, Poland's assistance should be at least triple the amount provided the Czech Republic or Hungary. Additionally, of the three countries, Poland's industrial base is generally considered to be in worst shape. This would indicate that on a needs basis, Poland should receive proportionally more assistance. While this macro analysis does not take into consideration other AID expenditures in related fields, it does suggest that AID should review its overall spending on Privatization and Enterprise Restructuring to ensure Poland receives AID funded assistance in an equitable balance and consistent with its needs.

Poland has considerably higher expenditures for Firm-Specific Transactions than the other two countries. This is entirely due to funding the Sectoral Approach, which was not used nearly so extensively in the other two countries. Poland also had slightly higher Policy and Program expenditures. This does not represent any one large program, although several programs relating to the financial sector make up a sizable amount. It is also a reflection that Poland has the broadest privatization strategy, encompassing various programs. Poland is lower in expenditures on Institutional Support. It has no project comparable in size to the SPA support in Hungary or to Crimson Capital in the Czech Republic.

Some of the more pertinent characteristics of AID support in Poland are cited below.

1. General Technical Assistance & Institutional Support

In contrast to the other countries, Poland has not received long term technical assistance similar to that provided to the SPA or to the Ministry of Privatization through Crimson Capital. Such assistance was never requested. In retrospect, it appears that such institutional support might have been desirable, to establish stability and continuity, especially in lieu of the numerous changes of governments, programs and personalities. On the other hand, the role of senior advisors in such a changing environment could easily have been become politically compromised.

2. Financial Sector Support

Two projects totaling \$924 thousand have been spent on financial sector support: one for Bank Regulation and Supervision at the NBP; the other for assistance to the Polish Securities Commission. These projects complement AID's Bank Training and Financial Sector Advisors projects, both channeled through the Treasury Department, as well as related projects for Tax Policy and Administration, channeled through the IRS and Treasury, and for Antimonopoly/Competition Law and Policy Development, channeled through the Federal Trade Commission and the Justice Department. In total, the commitment to the financial sector has been significant, well executed and appreciated by the host country.

3. Mass Privatization

As of the writing of this report, Poland's MPP has recently suffered a set back as the Polish Sejm (Parliament) failed to approve legislation for the MPP. It appears that the government of Madame Suchowcka will try to re-introduce this legislation at a later date, but neither its timing nor its form is known at this time.

Notwithstanding this set back, AIDs support of this program has been well received and has made a strong impact in shaping both MPP policy and form. Two technical support projects completed in 1990 and 1991 have been followed by funding a long term "back office" technical advisor. AIDs support complements nicely PHARE's funding of the MPP staff and the British Know How Fund's funding of the "front end" of the MPP, including selecting companies and fund managers.

In a evaluation, it is normal to concentrate on the program and not on the consultant or the consulting firm. But in this case, there has to be an exception. The qualifications, or rather over qualification of the consultant, have made a tremendous impact. Issues which have not even been considered by the host country (or the other donors and consultants) are being presented by the consultant with suggestions for the best possible solutions, some rather complex and innovative. Accordingly, even though AIDs funding is significantly less than the other donors, its assistance is extremely influential.

4. Sectoral Privatization

Poland is the only country where AID has funded a sectoral approach, in part because Poland was the only country pursuing this methodology. On surface, a sectoral approach appeared to be desirable for a number of reasons, to wit the government had very little knowledge of the shape of most of its industries, it seemed logical to establish a base line for privatizing companies within given industry sectors, and the government could also find out which firms need restructuring before privatization and which should simply be liquidated.

In retrospect, Sectoral Privatization does not appear to have been a cost effective expenditure of funds, especially if evaluated on the basis of cost per privatized firm. Perhaps

such an evaluation is not quite valid as the government also received information about the firms that cannot be readily privatized. Nonetheless, many sectoral studies were done not on a grant basis but on a success fee basis. Additionally, it appears that those firms that were targets for privatization would have been privatized anyway, and the government has yet to implement a successful program dealing with those firms requiring restructuring or liquidation.

5. Privatization through Restructuring/Liquidation

The Privatization through Restructuring program support has been a failure, in large part the victim of AID's bureaucracy. It took AID/Washington about eight months to approve the program, by which time the host government decided to change the scope of work. The request for these changes was not responded to in a timely manner nor in manner considered appropriate by the host government. The program has now been stalled for several months, apparently on a dispute over a \$20,000 advertising expenditure that must be - and to date has not been - approved by AID/Washington.

As a government program, Privatization through Restructuring, as well as its parallel program Privatization through Liquidation, is not proceeding well. This program, probably the only one in the three countries, addresses the difficult issue of what to do with state enterprises that simply cannot make it on their own in their present condition. In Poland, this issue has become highly politicized, especially with the changes in governments.

While this background clearly contributed to the failure of AID's project, the main cause still remains AID/Washington's inability to respond quickly and flexibly to the needs of the host government and the AID field offices. Indeed, an opportunity to come up with solutions or at least better understanding of how to effect restructuring has been lost.

6. Firm-Specific Privatizations

AID has funded only two firm specific privatizations in Poland: Huta Warszawa and LOT Airlines. Huta Warszawa was a small expenditure intended to help the government in the proposed sale of the "dinosaur" steel works to an Italian steel conglomerate. Although the expenditure was small, the Huta Warszawa project seemed like an excellent vehicle on which to build up credibility and create a presence. Unfortunately AID/Washington did not respond in a timely manner, frustrating the host government. When the funding was finally approved, the privatization had progressed to the point that AID's assistance was not only necessary, it also did not make sense. What turned out to be a small expenditure leveraged to make U.S. assistance look good, became an albatross that made U.S. assistance seem undesirable.

The LOT Airlines assistance seems to be a good project. We question it primarily in its cost effectiveness, and because it appears that without AID's assistance, LOT would probably have paid for the assistance. Nonetheless, LOT is a politically sensitive enterprise, and from the host government's point of view, AID's involvement is important and appreciated.

7. Ancillary Assets

Poland is the only country that launched a formal program to study the problem of ancillary assets and prepare a manual to assist companies spin off these assets. Ancillary assets are all the non-production assets that used to held by large conglomerates, such as recreation facilities, hotels, hospitals, schools, etc. This program was well conceived and executed. No follow up appears necessary at this time.

3.3.2 Comparison with Phase I Country Assessment Conclusions

Our evaluation basicly validated the findings presented by Price Waterhouse in the Phase I Evaluation of Privatization in Central and Eastern Europe as they pertain to Poland. Some general observations and comments as they pertain to the Phase 1 assessment are listed below.

1. The Framework for Privatization

Poland's transformation of its political, legal and economic framework for privatization was shaped by two factors: the Solidarity movement that successfully wrestled control from the communists; and the mess left by the legacy of over 40 years of communist rule.

The latter factor meant that the new Solidarity government immediately had to tackle very difficult economic issues. For example, in the run up to the 1989 election that they lost, the communists basicly opened the purse strings in an attempt to "buy" the election from the workers. And when they lost, the lameduck communist government kept the flood gates open. By the time Balcerewica implemented his plan, Poland was on the verge of hyperinflation. This inflation did occur, but only very briefly, as a massive devaluation of the Zloty - from around 3000 Zl/\$ at the time of the change in government in September, to 9,500 Zl/\$ as of January 1, 1990. The resulting catch up inflation hit Poland in January, and started subsiding in February.

The former factor meant that as Solidarity started to exert its political power, it found out that it was more of a political movement, based on necessity to oppose communism rather than to advance a cohesive new political agenda. As Solidarity began to put a program together, it recognized that its roots were in varying different social and economic roots, which resulted in its splintering into several factions, later into separate parties.

The Solidarity legacy also ushered in Lech Walesa as the country's new president, but without a real political party supporting him. For years, Solidarity and Walesa learned to operate very efficiently as the opposition. Neither was prepared to lead and govern.

Indeed, Walesa's call for presidential elections in the spring of 1991 had nothing to do with a need to replace General Jaruzelski - who had receded into playing a low profile, non-interfering role as president, modeled perhaps on the role the Queen of England plays in that country's politics - then a protest against some of the pain being felt by the workers from the

Balcerewicz plan, and a misperceived notion that getting rid of communism will automatically usher in a Swedish style of social capitalism. If indeed a change was necessary to get rid of old communists who were impeding change - as Walesa charge - then a new parliament was required.

The confusion and fragmentation caused by Walesa's desire to claim the precedence dealt a near fatal blow to the privatization process. When parliamentary elections were finally called, the split up of Solidarity was finalized as some 40 parties won seats to the parliament (including a Beer Lover's Party!). This parliamentary fragmentation was exacerbated by a hold over provision of the old constitution that favored small party representation, a feature favored at times by both the communists and by Solidarity.

Poland's political morass can be described as being part of the political maturing process. Parliamentarians realized that they owe their loyalties not to some vague concepts or to the people at the top of the political process, but to the electorate. The coalition of Madame Suchowska is a tenuous one, with seven political parties, but she has learned how to keep the coalition together, and the coalition members have learned that they must govern by being for a program, as opposed to being simply against one.

Poland will be much better served with a new constitution followed by new parliamentary and presidential elections. Parliamentarians have learned to spend long debates tackling philosophical issues -like abortion, teaching religion in schools, etc. - because for some of them, these issues are in fact the most important ones that need to be addressed first, whereas for others, they are a convenient way of postponing painful economic choices. In the meantime, we should remember that at least Poland has a freely elected government trying to figure out how a free government should be run and a transformation to a free market economy by made.

This political backdrop obviously affects the legal and economic transformation. Every change is debated to an almost absurd point. But at least the political process is working, however slowly. In the meantime, the people are not waiting for parliament. It is estimated that over 55% of Poland's workforce now works in the private sector; and this estimate might prove conservative as the no one in Poland has yet been able to adequately measure the strength of the private sector, especially as some of it still remains unreported. Probably the best indicator is what is not happening: the government is not caving in to wild cat strikes; the population as a whole does not support these strikes; mass starvation is not to be found; and no one is calling for revolutionary changes.

2. Corporate Governance

Since 1981, corporate governance in Poland was effected through the Workers' Councils. Since these Councils were an outgrowth of the Solidarity strikes, it is easy to understand that the workers were not enthusiastic about shedding a political right which they had won under such difficult circumstances.

Ironically, one of the most effective motivating reasons cited for the workers giving up this right is to get around what is called "popiwek", an excess salary tax. This tax was introduced under the Balcerowicz reforms to kill inflationary salary increases: any salary increase over inflation is assessed a tax that can be up to several times the excess increase. After having their salaries held back for several years, Polish workers are starting to reluctantly give up their rights to a Workers' Council by agreeing to at least under go "commercialization". This occurs when an SOE converts to either a limited liability company or joint stock company status.

At that point, a Board of Directors is appointed to take over corporate governance. For most firms, this Board is composed of local business and banking officials, not unlike the composition of many small, local companies in the U.S. The Board must be approved by the government at the time a firm is commercialized. Only the biggest, most politically sensitive SOEs seem to have a problem with corporate governance.

Another important feature in Poland's corporate governance effects the general manager issue. When the new parliament was elected in the fall of 1991, it mandated that all general managers stand new elections to their positions by the Workers' Council. This resulted in the dismissal of many general managers who were old communist nomenclature. It also brought into power many young managers who are eager to explore and learn new ideas on how to run a business, and a sensitivity that the business' success cannot be attained by walking over the workers who had just elected them.

3. Internal Privatization

Poland has taken the broadest approach to privatization. In part this is a response to the numerous changes in governments; in part, it is a result of a practical approach of letting privatization take whatever course is necessary to make it work. The net result is impressive: the World Bank now estimates that over 55% of the Polish workforce is in the private sector producing over 45% of the industrial output. The actual numbers might be higher as it is very difficult to measure the private economy in a country that never wanted to count it. In the services area in particular, virtually the entire service economy is in private hands.

While official statistics on privatizations of large SOEs are disappointing small, many of these SOEs have been busy restructuring themselves out of necessity. Under the Balcerowicz reforms, all state subsidies were cut off (although some indirect subsidies remained for energy and transportation). Accordingly, Polish SOEs had to start behaving like private companies even though they had not yet been privatized.

4. Mass Privatization

A key differentiating features of the Polish MPP is its insistence on bringing to the Polish companies in the MPP, foreign governance and access to foreign capital. Both goals are reached by having a foreign fund manager appointed to run each of the 20 investment funds that will be

set up. Additionally, less than 10% of Polish companies were selected for the MPP under criteria that included only profitable firms. Another key feature is that for those citizens who hold their bearer certificate to maturity, it represents risk diversification and professional fund management. Certificate holders will not have to choose in advance which firms they feel might be successful.

Poland's approach to the MPP has been described as top down. To many, this is a negative connotation. Yet when the program is reviewed in its totality, it appears to be a very prudent approach that takes into consideration the companies in the MPP and the citizens who hold the bearer certificates.

5. Lessons Learned

Poland lessons from privatization are too often based on bad examples. First and foremost, privatization is an intensely political process. Having long open debates on the privatization process might prove healthy for a country in the long run. We should be prepared for set backs in the privatization process, and not be disappointed by them. Each country must reach its own conclusions; Western advisors must be country literate and bring with them the highest credentials in order to be effective.

Many roads to privatization should be taken. New private enterprises are as much a part of the privatization process as are transformation of SOEs. Likewise, small privatizations of municipally owned firms or spin offs of ancillary assets are also an important part of privatization. Institution and infrastructure building is a very important part of the privatization process.

3.3.3 AID's Role in the Privatization Process

The Polish government does not have a favorable perception of AID assistance. At worst, the host recipient is angry; at best, confused. The core reason for this is AID/Washington. Specifically, we have found AID/Washington to be slow in responding to host government and AID/field office requests for assistance - in some cases totally non-responsive - and arbitrary in its approval process.

When AID assistance was first offered to Poland, field visits to Poland were made by AID/Washington and the government of Poland was led to believe - as it should have - that AID assistance would be quickly forthcoming. In fact, many projects were delayed, modified or simply not acted upon, leaving many in the government to lose faith in AID. Huta Warszawa is a good example of this.

Since that onymous start, several well executed projects have helped repair the damage. Examples of this include the SEC assistance, the MPP support, and the NBP assistance. However the response time to these was slower than what it could have been. The problems of response continue, especially response time to setting up new projects and modifying existing

ones. An example of this is the suspended status of the Privatization through Restructuring project due to the failure of AID/Washington to approve a minor expenditure for advertising.

Similarly, AID/Washington still makes decisions which appear to be arbitrary or that run counter to host country and AID field office recommendations. An example of this is the decision to not provide additional funding the Glass Sector Privatization project at point which the government perceived to be critical to the privatization of Sandomierz, the largest firm in the sector.

3.3.4 Future Issues

Specific issues mentioned in the evaluation scope of work and ones that AID needs to consider for future programs are cited below.

1. Financial Sector

Future AID assistance will have to concentrate more on the financial sector. This is a logical outgrowth since other easier issues are being addressed and resolved, whereas the problem of the bad loans - which take a long time and a lot of effort to resolve - has yet to be addressed. Bank privatization should not be aggressively pursued until a solution of the bad loans is mutually agreed upon.

From a sequencing point of view, enterprises should be privatized as soon as possible: not only is it easier and faster to privatize individual firms, banks should have a healthy loan portfolio before they are privatized. In effect, bank privatization should be the last step of the privatization cycle, and resolving the bad loan issue the next to last step. In a sense, this sticks the banks with some of the problems of the privatization process, but an economy making such a dramatic transformation in such a short period of time needs this "safety valve".

Significant, long term work needs that should be considered in the financial sector, both in the banking and the non-banking fields include:

Banking: 1) Bank restructuring, 2) Bank regulation, 3) Functioning interbank infrastructure, 4) Intercompany debt work out, 5) Bad loans work out, 6) Bank recapitalization, and 7) Bank privatization.

Outside of banking assistance, AID should consider providing technical assistance for projects that support the establishment of a functioning capital market. The Polish economy will need to raise significant amount of monies to transform Poland's industry, far more than either the banks or even foreign donors can support. Only a flourishing free capital market will be able to meet this demand. Accordingly such successful projects as those at the Stock Exchange, the Securities Commission, and the Antimonopoly Agency should be continued. Primary areas to be considered include:

Non-banking: 1) Warsaw Stock Exchange, 2) NASDQ type of OTC market, 3) Brokers
4) Fraud, 5) Antimonopoly, 6) Insurance, 7) Pension Funds, 8) Fund Management.

2. Mass Privatization Program

Although the MPP recently suffered a legislative set back, there is still reason to believe that the program will eventually be passed by the parliament. In the meantime, there still are back office issues that need to be resolved.

AID support of the MPP should continue along its current path. There are still many back office issues which need to be resolved. In a way, the delay caused by the parliament's failure to approve the MPP will provide additional time to sort these issues. Additional AID involvement does not seem necessary at this time as other donors are supporting other aspects of the MPP.

Going forward, AID should evolve towards more of an infrastructure building role - for example to assist in establishing an OTC market and mechanism - or towards an operational support role - to ensure that trading proceeds smoothly. Additionally, once the MPP is implemented and fund managers selected, AID should consider supporting the operations of U.S. fund managers.

3. Corporate Governance and Privatization through Restructuring

The issue of corporate governance is very important. However, we question whether AID assistance to improve the efficiency of Boards of Directors of SOEs would accelerate the privatization process. As a general comment, becoming an effective member of a Board takes years of background; it is not something that can be learned from a training course. However, there could be some information concerning Board mechanisms and recent applicable laws which might be appropriate for a training course.

Obviously for SOEs that have not yet transformed themselves, this is a moot point since these SOE's do not have a Board of Directors but rather a Workers' Council. For those SOEs which have transformed themselves, the government should not remain a majority owner for an extended period of time; thus any such assistance will not be cost efficient since the Board will most likely be replaced by the new owners. Foreign buyers will bring in their own foreign Board Members; firms that go into the MPP will have foreign fund managers controlling the Boards.

For any transformed SOE that does not pass to majority private ownership, it would be more cost effective and easier for the government to contract for a management team to run these firms rather than to concentrate on the Board. This has already been attempted through the privatization through restructuring program. This program is a good idea, but one that can easily be politicized. As mentioned in Section 2.2, AID's experience to date with the Restructuring program has not been good. On the otherhand, the Department in charge of these programs seems to be satisfied with the services being provided and financed by the World

Bank. Consequently, AID's assistance in this area should not be needed. However, if it is requested, AID should be cautious and insist on establishing mutually acceptable, clearly identifiable goals which help the program. Also, it should focus on developing the institutional procedures for managing this program, rather than the firm-specific analysis. [Note: AID should also be cautious in providing assistance to the "Privatization through Liquidation" program. However laudable the goals of this program may be, AID should be sure that its role focuses on setting up an institutional mechanism, rather than providing firm-specific assistance.]

4. Facilitating Foreign Investment

AID has not played a role in facilitating foreign investment. However, it has identified and begun to address some of the major disincentives to foreign investment.

One major disincentive to investors is the lack of a clearly defined legal framework, particularly in the areas of property rights and tax assessments. In the former area AID through its IRIS project (financed under another project) is helping to define collateral laws and develop the necessary infrastructure support (e.g. setting up a computerized and centralized system for tracking liens). This support is absolutely critical and should be continued.

Additional technical assistance is also required for tax policy. Currently many state owned enterprises are not paying taxes, causing a large budget deficit. To close this deficit, the Polish government has raised taxes on private, tax paying firms. If this trend is allowed to continue, the profitable private firms will either go bankrupt, or will devise tax avoidance strategies - either legal or illegal - which will further complicate the budget crisis. Similarly, import duties and customs charges - which also were raised to fill the deficit - are at such a point that they are protectionist in nature. This will cause problems when Poland will need to lower its duties to join the EC.

Other areas mentioned by AID officials included the weak banking sector, political instability and the strength of the trade unions. As already mentioned, AID has provided help in the banking sector. The other two areas do not lend themselves to direct project assistance.

Finally, the success of AID assistance to the Czech MOP through Crimson Capital/D&T suggests that similar support to the Polish MOP could provide tangible results. An example of this might be a transaction unit to help pull together all the "sellers", or a senior long term advisor to the Minister. Such assistance, however, will clearly depend on the desires of the government and the extent to which it fully supports such assistance.

5. Support to Municipalities

AID should most definitely support the privatization of municipal firms which can be transferred to the private sector without central government approval. In particular, this support should continue through such programs as the Peace Corps, the MBA Enterprise Corps, the IESC, IBIS and GEINI. This support is essential as it provides a lot of bottoms up privatization

at the local level, extends legitimacy and transparency to this process, and allows for good U.S. and AID visibility throughout the country.

6. Other Privatization Methods

AID should be open to support additional privatization methods. One that is being used successfully in Hungary is ESOPs; another is low interest credits for individuals to buy existing enterprises.

7. Follow on Training and Monitoring

Privatization is a process, and it does not end with a privatization. Training for management, finance and MIS are just a few of the future needs. Monitoring will be required to ensure that privatized firms will succeed and not suddenly go bankrupt, and that private buyers of these firms - both foreign and domestic - do not strip the firms for their own benefit and then walk away from them.

8. Firm Specific Assistance

The lessons from Huta Warszawa and LOT Airlines point to a policy of restraint regarding future AID assistance for firm-specific assistance.

- * The main lesson from AID's assistance to Huta Warszawa is that the decision making needs to be decentralized to the field. (see Section 2.4 for more details). While the request for assistance was minimal and could have provided AID with good publicity early in its privatization assistance, disagreements and a lack of communication between AID/Washington and the field resulted in excessive delays.
- * Lessons from the LOT Airlines assistance might be premature since LOT has not yet been privatized. But to date it seems that AID assistance played a useful, but not critical role, in helping the company spin off some of its departments to foreign partners (e.g. AMR--ticket handling, baggage handling ; and SAS--food service contracts). Still, such assistance is expensive (more than \$1 million spent) and take a long time to resolve. Also, there are questions of whether AID assistance should go to firms that large that could possibly pay for part of the assistance on their own.

3.4 Hungary

3.4.1 Distribution of Program Activities

Since August 1991 AID has financed a total of 13 projects or work orders totalling (in obligated funds) \$7.2 million dollars. The breakdown of these projects by type of assistance is:

Policy/Program Support	\$2.1 (29%)
Institutional Support	\$4.0 (56%)
Firm-Specific Assistance	\$1.1 (15%)

Total:	\$7.2

Hungary is the smallest of the three countries and has been allocated the least amount of funds. It has, however, the longest privatization program history. More than half of the funds have been for "Institution Support", almost completely through the provision of a long term advisor and other short term tasks in the State Property Agency. In fact, these contracts (PIOT # 1183482, # 3622073) makes up 70% of all the privatization work authorized by AID for Hungary. Together, "institutional support and policy/program support represent 85% all the work done in Hungary. This is in marked contrast to the distribution of effort in the Czech Republic and Poland, where the percent of total work done in these two categories has been 70% and 33% respectively. Finally, unlike the other countries, Hungary has spent the least amount on "Firm-Specific Transactions" only 15% compound to 32% in the Czech Republic and 71% in Poland.

More specifically, some of the more pertinent characteristics of AID assistance in Hungary include the following:

1. General Technical Assistance to SPA

The nature of the Long Term Advisor's work has been very different from that of the advisors in the other two countries. As stated, their work has been very focused; in Hungary, the Advisor's work has been very diverse. By its nature, the work of a long term advisor is continuous over a period of time and is therefore long term. But in Hungary's case, the Long Term Advisor was successively engaged in a series of finite tasks so that from a task basis, much of his work, about 80% of it, has been on projects that were short-term, in that they had a beginning and an end and then the advisor went on to another task.

These tasks have been primarily related to programs and procedures rather than directly to policy formation, although of course policy was involved in helping to make the Agency function. In approximate order of size of effort, the Long Term Advisor has been involved in a) designing and bringing on stream information systems, b) helping establish steps in operating processes and procedures, c) supporting certain specific programs, some of them consultant assignments that are described below, d) procuring equipment, mostly computer equipment (over

\$400,000 of it; a function not performed by AID in the other two countries), e) providing training himself and from his staff, f) counselling and advising at both top and middle management levels, more recently, g) providing support to the Self-Privatization Program, and h) assisting in donor solicitations.

2. Limited Assistance to Self-Privatization

Recently, AID assistance has played a contributory role in the Self-Privatization Program, both with SPA and with Pri-Man. (For a description and further discussion of this program, see Section 2.3.1 of this report.) Not a lot of money has yet been spent, partly because the program has only recently become important and partly because of the secondary role that we have played.

3. Start Up of New Privatization Initiatives

Even more recently, in response to a Government decree of December, 1992, the SPA is investigating the feasibility of new programs to speed up privatization. AID has financed initial work and is considering a proposed follow-on PIOT (first called COMPASS and now IMPACT) to evaluate and help implement some of these programs. At this stage, these are all experimental. They include leasing, installment sales, and potentially of considerable importance, a credit certificate, i.e. voucher program.

4. Financial Sector Assistance

Also, of considerable potential importance is work in the financial sector, in this case concentrating in the area of intercompany debt. Only the introductory Phase I of this work has been done.

5. Development of ESOPs

Hungary is only the third country in the world to pass an ESOP law. AID has financed both preparatory and follow-on work for this law. 20 transactions have been completed and more are in process. Of all of the kinds of projects in which AID has been engaged, ESOPs are one of the hardest to mount and carry through to conclusion. Therefore, these achievements are both very impressive and unprecedented.

6. Limited Firm-Specific Transactions Work

AID has also engaged in some transaction work in Hungary. A program called Quick-Form is presently stalled for reapproval in Washington. It is, however, a typical random set of small enterprise transaction proposals and as such is not especially important or promising.

More importantly in term of dollars spent, is Hungary's only large firm transaction, Monor State Farm. (Described further in Section 2.4.1.) We have described this both as a large

firm and a Sector Study, because the project was intended to be a pilot for the State Farm Sector. (120 of them in Hungary.) As a sectoral approach, this was a good idea that failed and was therefore expensive. The usual combination of national politics, inept local management and government mismanagement combined to reduce this promising prospect to a bankrupt case now with only minimal value and probably beyond rescue, at least at the level at which it could have been. AID/Washington played a delaying role in authorization that in retrospect is to be criticized because a good case can be made that prompt action and a better sense of timing might have brought about a significant success. That opportunity passed us by.

3.4.2. Comparison with Phase I Country Assessment Conclusions

Especially when Hungary's privatization program is compared to those of the Czech Republic and Poland, it can be described as very much subject to "top down" government direction. This came about as a reaction. Following the revolution, a process of spontaneous privatization had come into full flower. This was a type of privatization in which, through various legal loopholes, a buyer and an SOE Workers' Council and management could strike a self-serving privatization deal with no restraints from government or any third party. Gross abuses occurred. Strong governmental restraints ensued, and while these were later eased and modified, various restraints still persist to this day.

Under these circumstances, the fast start in privatization that Hungary enjoyed initially has slowed down. Perhaps this is inevitable in this kind of a directed approach. Also, perhaps a greater proportion of the "jewels" in Hungary attractive to foreign investors are now gone, more so than in the other two countries. Certainly except in the field of retail privatization (a success in all three countries) the efforts that the Government has made to initiate major transactions have generally been met with failure.

The main difference, of course, is that Hungary does not have a mass privatization program in operation or even very far along in concept (bearing in mind that as of this writing, although Poland has done a lot of good preparatory work, mass privatization in that country is not yet a law and therefore not yet operable. As of March 20, 1993, the Polish Parliament has just turned down the Government's mass privatization bill.))

Despite this slow down and loss of momentum in Hungary, a sense of proportion should apply. Compared to what it could have been, Hungary's privatization program is not impressive in its speed, but it can at least be described as at a respectable level. It has moved faster than all but a few other countries in the third world. Statistics in the Phase I Report show that while it is behind the Czech Republic in progress, as measured by number of privatizations and percent of the economy privatized, it is ahead of Poland. See further discussion at the end of Section 3.4.4.

Compared to the other two countries, Hungary is obsessed with the position that there must be payment received for privatization value transferred. It is relevant that Hungary has the

highest per capita debt of any country in Europe, at least outside the N.I.S. We note also that Hungary, more than the other two countries, is wedded to book value as the basis for fair market transfer. All of the countries try to achieve a book value price, if only to avoid criticism, but book value as a benchmark is strongest in Hungary.

Lastly, Hungary has recently been the victim of a strong political reaction to the "invasion and takeover" by foreign capital. This has, in turn, caused a reaction from the Government which is trying to achieve greater domestic content in future privatizations and to stimulate programs that will promote this.

3.4.3. AID's Role in the Privatization Process

AID's role has been positive in Hungary, albeit difficult to quantify. Unlike Poland, but perhaps not as much as in the Czech Republic, there seems to be significant goodwill generated by the program and an ability to leverage AID resources with other donor financing. Furthermore, AID has been able to be part of (in some cases with a large role, in others a small role) several successful new privatization initiatives -- namely, the ESOPs program and the Self-Privatization program. Most of these accomplishments have been achieved, even though AID management of the privatization projects has often been problematic. These issues are discussed below.

1. Goodwill Generated

Through its assistance to the SPA and related programs in the SPA, AID has been able to develop a reasonably good image as a timely provider of valuable assistance.

While it is difficult to assess the worth of the eclectic tasks carried out by the Advisor to the SPA, one important by-product is that the work of the long term advisor generated a great deal of good will within the Government for our aid. Government officials in close contact with the advisor speak very highly of him. They recognize that he ran interference for the agency saved them a lot of delays and headaches.

In addition, AID has been able to provide good "seed" money for promoting the ESOPs program. The success with this venture has prompted officials in the SPA to look to AID for continuing support and assistance in developing new privatization initiatives.

2. Donor Coordination

Donor coordination in Hungary has been the strongest of the three countries visited. More than the other countries, AID in Hungary has been the most successful at adapting its programs to fit around the edges and in the niches of other donor-financed programs.

The most successful coordination has been with the EC/PHARE. In Hungary, PHARE's annual appropriation for privatization is around \$6,000,000 annually and building up. AID

spends around \$2,000,000 and this may, in the future, be subject to some reduction. The profile of PHARE shows that its interests lean toward:

- training, especially formalized classroom training
- organizing its work in projects. This means a tendency toward working on transactions.
- placing advisors, or even groups of people, in individual ministries on long-term residency. PHARE cites procuring enough competent people on this longer term basis as one of its biggest personnel problems.

Our work has been and should be accordingly complementary to the role they will fill.

It is possible that Hungary will represent the pattern of the future as far AID's relative role goes: one in which PHARE, or even the Know-How Fund, becomes the more prominent principal player and we take a lesser, more selective role.

Notwithstanding this, in comparing the world of donors, and despite some of our mistakes, we come off comparatively very well in the opinion of the host governments. At least at present, or until PHARE improves, we appear more responsive. We also have the reputation of being less self-seeking, requiring less trade reciprocity or sales tie-ins than other donor nations.

3. Problematic AID Management

As mentioned throughout this report, a lack of coordination between AID/Washington and the field has resulted in numerous delays, many of which have had a devastating effect on project continuity, timeliness, and effectiveness. Slowness in clearing many of the PIOTs, especially as of fiscal year end or in light of budget cuts, and micromanagement of line item budgets and detailed expenditures have all taken their toll. Fortunately for Hungary, the AID office has had a number of outstanding authorized non-IQC contracts that could be utilized to get some projects going or to sustain them while decisions on work orders under the privatization contract were under review.

Some examples of management problems are presented below.

* Perhaps out of proportion to their specific importance are the impressions made on us and on the Hungarian Government by the reviews now going on that relate to the details of Hungary's Quick-Form Privatization Program. There is a name change at issue (this does involve a change in the scope of work, although in our opinion, not a significant one). Even more telling is the fact that all progress has been suspended while an incidental \$20,000 of advertising expense to locate potential investors is evaluated in Washington (and by Contracts, who is hardly capable of judging the issue). We have not run down all the ramifications of this but it certainly seems an example of over-centralization and not in accord with common sense.

Lack of any flexibility on the line item amounts within a total project allocation, even when it is not proposed to change the total, has the same bad effect on efficiency of program.

* In the financial sector, AID was unable to respond in timely fashion to GOH requests to review their banking sector. As a result, short term experts were not provided until after the government had already formulated an initial and flawed financial sector development strategy.

* The contractors for the COMPASS project have been carrying out activities, even though their original scope of work has changed and necessary contract modifications have been sitting in AID/Washington contracts office for several months. While all the principal parties (government, AID, contractors) have agreed to the change in scope, the contractor risks not receiving payment if the modifications are not approved by mid-April. Conversely, if the contractor had decided not to continue with its assistance for 3 to 4 months, AID could have severely damaged its reputation with the SPA.

If AID is contemplating a change in the IQC form of contract, it will be imperative that another delay gap absolutely be avoided.

3.4.4 Future Aid Issues

There are several areas in which AID should contemplate terminating existing work, expanding new initiatives, or developing new programs of assistance. These are presented below.

1. Assistance to SPA

We have been asked whether AID support of the SPA should continue past September 1993. This corresponds with the termination date of the incumbent Long Term Advisor's contract. The question is whether to renew him and if so, for how long.

The GOH's stated intention is that SPA is not to be a permanent agency and that it wind up its operations by early spring of 1994. In fact, those operations that will last beyond about that time have been, or will be transferred to a more permanent sister agency, the AVRT. This is an agency that will be the caretaker for those continuing activities related to privatization, particularly those 163 SOEs presently in the strategic sector and scheduled to remain a Government ward for some time, plus any other enterprises not in the process of privatization by then. (Half of the assets in this "strategic sector" are power companies, another quarter are oil and gas.)

We think the goal for the dissolution of SPA is a bit optimistic, but not way out of line. We understand the present incumbent Long Term Advisor is willing to stay past September 1993

if needed, but we think the service has served its purpose and run out its natural course and can be discontinued.

The remaining question is whether some similar long term advisorship should be repositioned within one or more ministries. This would be limited, as we see it, to the AVRT, the of Ministry of Finance, or the Ministry of Privatization.

The two important questions are whether the Government wants the service supplied in that way and whether we can contract a highly qualified individual. We have seen that the latter consideration is particularly important in long term advisors.

The AVRT has not shown any interest in having an advisor placed with it. (In fact, all three countries have the same split between the privatization agency and the caretaker agency and none of the latter have expressed any such interest. We think we should push the AVRTs in at least one area -- bankruptcy, discussed below.)

The possibility of placement in the Ministry of Finance should depend on the progress and outcome of the financial sector work, therefore, absent any request, this should not be decided until next summer.

The possibility of an advisor placement in the Ministry of Privatization in one sense would be the closest thing to extension of the present long term advisorship. It would be at a higher governmental level. The possibility should be explored to determine interest.

2. Support to the Financial Sector

Throughout this and other sections we have strongly endorsed the work being developed by KPMG in the financial sector. This financial work is similar to that being performed in Poland. Both these two work assignments have been excellent and have helped establish the validity and worth of this type of work. Even more, while it was brief, Phase I of the Hungarian financial assignment was excellently performed, almost a model of what such an assignment should be. The best proof of this is the fact that the GOH was swayed in midstream to change its initial financial sector reform strategy by this accurate, but late-entry advice. The prospect is that it will be even more influenced by Phase II. We think this work is excellent and should have the highest priority to continue.

3. Development of a "Crimson" Assistance in the SPA

The question has been raised whether a Crimson type operation should be started up in SPA, given the success enjoyed with Crimson in the Czech Republic. We of course endorse replicating it. However, given Hungary's particular situation, it should not only process foreign investment transactions but domestic ones also in anticipation that foreign investment opportunities will soon decrease in volume. There is another serious note of caution. If SPA is in fact to be out of business as early as the end of 1993, we question whether such a function,

initially staffed by foreigners with the objective of training locals to take their place, can be up and running by that time.

The work with Pri-Man has been conceptually similar to the Crimson model before it. Ways should be sought not only to continue this support but involve our aid more centrally in this project.

4. Support to New Privatization Methodologies

As to the new experimental speed-up programs, we have some seemingly contradictory advice. At present, they are just that -- experimental and we think some of them are at present dubious of success. The Government has as its goal that these programs, collectively, should account for 75% of some 1000-1200 privatizations to take place during the next year. At present, this seems quite unlikely, except for the possibility that the voucher program could take off. So we urge caution at present as to the amount of time devoted to these experimental programs. AID should carefully assess the feasibility of programs before investing significant resources. If it looks as if certain of the programs are winners, then we urge, even with some risk, that involvement begin and at a somewhat heavier level than has been the practice in the past. The purpose of this is to position ourselves more centrally in programs that are likely to be important.

This is particularly the case with the possibility of a voucher program. The Government is being urged by its citizens to go faster in privatization and to give the domestic sector, i.e. the public, a bigger share. People are well aware of the Czech program and don't see why they shouldn't participate, if not on a basis that is free, at least at bargain rates. An election is coming up in a year. All these factors make some kind of a voucher program so politically compelling that the odds are that any half-reasonable program will go through Parliament and be welcomed. AID and its contractors, however, have perhaps the largest pool of knowledge about mass privatization of any agency in the region. It would be a waste not to apply the lessons that have been learned to a new situation where the broad issues are the same that have already been dealt with in the other two countries.

We urge that a program be developed and persuaded to the GOH for AID to provide expertise on any possible forthcoming voucher program and that this be done sooner rather than later. At the risk of some false start or waste, we think it is worth being out in front on this one.

5. Dealing with Bankruptcy and Intercompany Debt

In all three countries, we think there is one big looming issue forthcoming. That is what to do about inter-agency debt and the related subject of the specter of indicated bankruptcy for many firms when accounts are finally squared or resolved. The financial sector work scheduled for Phase II in Hungary is aimed right at this problem and to some extent it is also so aimed at in our Polish assignments. All three countries are braced for this problem. Perhaps characteristically, Czechoslovakia is not taking preparatory steps, Poland and Hungary are.

In each country, the two agencies most directly concerned are the Ministry of Finance and the agency (there are different names in each of the three countries) that inherits the caretaker function downstream from the Ministry of Privatization, which in Hungary is the AVRT. We think work on bankruptcy and debt problems already scheduled in Hungary (but not yet cleared as to authorization) should proceed and similar work should be urged on the Finance Ministries in the other two countries. The bankruptcy law in Hungary is inappropriate and needs work; the same may be true in the other two countries.

Another aspect of this broad bankruptcy question is the question of work outs. If 30% of all the original lists of SOEs will go bankrupt (an estimate we have heard mentioned) that means work outs for some portion of about 4000 enterprises in all three countries, substantially more than half of them still state-owned.

PHARE has expressed an intention to work on these work outs, on a "transaction" basis -- that means individually, enterprise by enterprise. We think this approach to the work will be subject to the same cost-effectiveness difficulties that we have observed in work that AID has done on individual privatization transactions. We would rather see AID working at the policy level on the bankruptcy question, with the actual work outs left to others to pursue.

6. Final Comment on the Question: "Is Hungary privatizing too slow"

In 1990, when the privatization program began, the GOH announced that its objective was to privatize 50% of its state owned assets that accounted for about 88% of the country's non-agricultural GNP and to do so within three years. While the starting date was never specified, it certainly was the objective to accomplish this goal by no later than the end of 1993.

At the end of 1991, 7% of the state owned asset value had been privatized. At the end of 1992, 17.7% had been privatized. This was stated to be well ahead of target. It is anticipated that 25% will be privatized by the end of 1993. A straight extrapolation says it will be two or three years before the original goal is reached, at best, 1995, if some of the new initiatives materialize.

Does it matter if it takes this long, a few years longer than originally forecast? Probably not. However, in order to achieve the second 25%, it will be necessary to tackle some of the big, vital assets that at present the government intends to reserve to itself for the indefinite future. The 163 enterprises that the GOH intends to reserve as "strategic assets" probably represent something approaching half of the missing remaining 25% that the Government needs to privatize in order to achieve its original goal, or, alternately, to have an economy whose main components are each predominantly subject to the forces of a market-driven economy. Tackling the privatization of this kind of asset has proven especially difficult in other countries, and experience in the rest of the world tells us that governments are almost always slow and timid about privatizing this class of assets.

So the danger is not with the speed or slowness of the present rate of privatization; it is rather with the danger that the slowdown experienced as the program seems to run out of gas will slow down further as we get down to the tougher candidates. This is despite any boost from new privatization initiatives which could turn out to have only a minor effect.

This suggests that even a secondary fillip coming from a voucher program is the stimulus needed to put the economy predominantly into the privatized camp.

4. SUMMARY: HAS AID ASSISTANCE MADE A SIGNIFICANT DIFFERENCE?

4.1 Measurement of Impact

Fundamental to the evaluation of any program is an analysis of the impact of AID assistance. As pointed out in the scope of work, it is useful to identify qualitative and quantitative indicators to measure the progress of privatization activities.

There are a wide range of indicators that are relevant to defining success in a program. (See Appendix 6 for a list of impact indicators submitted to AID/Rep offices for comments) On a general level, some of the more relevant country-specific indicators might include: number of privatizations (by size, industry, country, investor), revenue generated by privatizations, foreign investment generated, change in employment (overall, gender specific), new investment committed and technology improvement.

The Phase I country assessments provided some of this information. It was estimated that the overall number of privatizations and level of foreign investment by country is as follows:

	<u>Czech Republic</u>	<u>Poland</u>	<u>Hungary</u>
1. # of Privatizations:			
a. Case by Case	63	54	83
b. Mass Privatization	2,000	N.A.	500
c. Book Value (\$ US billions)	20.3	0.4	8.1
2. Foreign Investment (\$ US billions)	\$2.3	\$4.2	\$1.5

At the firm-specific level, some of the more relevant areas of analysis to judge success might include: change in productivity (sales/employees), return on assets employed, change in sales (domestic vs. export, by country, by product mix), change in capacity utilization, change in earnings, change in market share, number of training programs and trainees (by subject area, country, private vs. public, location).

A logical question with regard to all these indicators is: "What role did AID assistance have in these benefits?" More appropriately from an economist's point of view would be a comparison between the "with AID assistance" and "without AID assistance. That is: "What would have happened without AID support?"

Besides these quantitative indicators, the evaluation team also sought out less tangible, but in some cases, equally important qualitative analyses and political insights. Based on

interviews with AID, government and firm beneficiaries, other benefits of AID assistance have included:

- * increased political support for privatization policies,
- * new regulations,
- * improved management skills,
- * faster processing times (which could be quantifiable, but were not documented),
- * better credibility,
- * more coherent and consistent procedures and
- * improved transparency.

The development of privatization programs is both an economic as well as social and political transformation. In all areas -- economic, social and political -- there is ample room for defining strengths and weaknesses of program assistance without necessarily distilling such definitions down to concrete figures. As shown in the next section, this last set of qualitative criteria turned out to be the only ones by which to judge the impact and success of AID assistance.

4.2 Actual Impact

4.2.1 Overall AID Impact

On balance, the results of AID's privatization initiatives in the Czech Republic, Poland and Hungary have been mixed. Out of a total of \$31.3 million dollars obligated for projects, it is estimated that about 60% of the expenditures have either resulted in outright successes (37%) or mixed success (23%). The remaining projects were either too incomplete to define or resulted in no tangible political or economic benefits.

The most successful projects have included:

Czech Republic:

- * Institutional support rendered to the Ministry of Privatization through Crimson Capital/Deloitte & Touche (D&T)
- Development of fund portfolio investment management in the Czech Savings Bank

Poland:

- * Assistance to the Mass Privatization Program (MPP) through the National Investment Funds (NIFs)
- * Assistance in bank regulation and supervision

Hungary:

- * Advice on financial sector development
- * Assistance in self-privatization program
- * Development of an Employee Stock Ownership Program (ESOPs)
- * Placement of long term advisor in State Property Agency (SPA)

Each of these "successful" projects achieved one or more of the following objectives:

- * Helped effect or speed up actual privatizations;
- * Established necessary financial institutional structures for future privatizations and market development;
- * Achieved concrete economic benefits (e.g. increased purchase prices, investment)
- * Provided tangible political benefits

With few exceptions, none of the countries visited or projects were able to quantify the overall impact of privatization programs, much less clearly attribute AID assistance to the achievement of these benefits. In each country the evaluation team left a list of indicators (see Appendix 6) for each of the AID/representative offices to complete. To date, with the exception of the Czech Republic, the team has still not received responses.

In the absence of quantitative data, the evaluation team ranked the individual projects based on assessments provided by government officials, contractors, recipients of services and comparative analysis with other programs in the country. In all the above "successful" cases, there was generally unanimous favorable opinions regarding the benefits and assessments of what would have happened "without" AID assistance.

The "mixed success" projects were those in which opinions regarding the achievement of the above objectives were either mixed from all the groups interviewed -- i.e. some positive or negative -- or qualified in some manner. Similarly, projects considered to be "indefinite" or not successful, were those in which the general consensus seemed to be generally negative or the objectives of the original scope of work were not yet achieved.

Each of the three countries studied had a "success plus mixed" ratio of better than 50% of total expenditures. The Czech Republic registered the highest level of "successful" expenditures -- 50% of total funds obligated compared to 23% in Poland and 36% in Hungary. Both Poland and Hungary had the highest level of "mixed success" expenditures -- 36% for both countries compared to 5% in Czech Republic.

* * * * *

The only quantifiable data came from the Crimson Capital/Deloitte & Touche support provided to the Ministry of Privatization in the Czech Republic. This assistance has focused on a total of 102 transactions with purchase price proceeds amounting to more than \$780 million and new investment commitment of more than \$930 million.

What role did the advisors play in either increasing financial and other non-financial commitments? And, even more significantly, what role did the advisors have in making the deal possible in the first place?

* Anecdotal evidence from interviews with companies shows that the advisors were greatly appreciated for providing technical consistency in an otherwise unclear, high turnover environment within the Ministries. In one company (FEROX), the advisors were able to significantly increase the purchase price and environmental liabilities. In another (CUKERNY), however, the advisors were not able to overcome political battles between ministries, and an initial investor offer eventually was withdrawn as market conditions and the financial status of the company deteriorated.

A review of the files shows that in many cases, the advisors were able to ensure more favorable terms for the government. Benefits include (based on a partial sample of negotiated deals):

Increase in Purchase Prices-- More than \$44 million; Achieved price increases in more than 40% of the deals negotiated.

Increase/Strengthening of New Investment -- More than \$68 million in new investments; Improved or strengthened investment commitments in 50% of the deals.

Maintenance of Employment Levels -- Strengthened investor commitments to maintain employment levels in more than 40% of the deals negotiated. In one case, got company to agree to retraining of 453 employees.

Improved Environmental Liabilities -- In numerous negotiations, the advisors established commitments by investors to assume environmental liabilities and/or reduced the environmental indemnity claim period against the government.

Increased Ownership by Czech Citizens -- The advisors played a role in increasing the voucher component, an important element of the Czech mass privatization program, in at least eight deals.

Other Benefits -- Besides the above benefits, the advisors have also been instrumental in guaranteeing the transfer of technology, management know-how. They also have obtained commitments to reinvest profits and maintain facilities.

4.2.2 Employment and Social Issues

One of the most disruptive consequences of privatization is an increase in unemployment, and along with that, a decrease in social services. To date, AID assistance, with some exceptions, has not developed a strategy or project for addressing these issues.

The severity of the unemployment problem varies by country. In the Czech Republic official unemployment is the lowest of the three countries, estimated at around 3% nationally. It is likely to get much worse, however, in the next year or two. To date, many firms -- privatized and state-owned -- have not begun to lay off workers. In the case of privatized firms, particularly those involving foreign investment, agreements with the government include employment guarantees for, on average, 1 year. In the case of state-owned enterprises, the lack of a bankruptcy law has not required the government to make politically difficult layoffs.

In Poland, the structural adjustment process is perhaps the furthest along, and with it the most severe unemployment problems. In late 1989 the Polish government took dramatic steps towards reducing subsidies to SOEs. Today, national unemployment is around 14%, although in some small towns it is closer to 25%. While unemployment may not increase as dramatically as the Czech Republic, it will remain a problem as privatization progresses and firms cut jobs. Also, similar to the Czech Republic, Poland is still in the midst of drafting a bankruptcy law, which when passed and enforced will probably result in significant unemployment.

In Hungary current unemployment is not quite as high as Poland's, but higher than the Czech Republic. Not surprisingly, unemployment will grow in Hungary for two reasons. First, Hungarians were slow in fully recognizing the full impact of the breakdown in the COMECON markets. As late as 1992, some of the subsidiaries were still making their traditional deliveries of products to larger firms which formerly passed the goods on to COMECON countries. The larger firms are now refusing these products, but decisions concerning other courses of action, including layoffs have not worked their way through the system yet. Second, significant numbers of jobs are likely to be lost as the less profitable SOEs are privatized. Finally, even though Hungary has passed a bankruptcy law, it has not been enforced. Consequently, similar to the other two countries, unemployment will increase if and when the law is properly enforced.

AID assistance has in some instances helped to cushion the negative social impact of privatization. For example, the Crimson Capital/D&T group consistently includes employment guarantees in its negotiations with foreign investors. As mentioned previously, nearly 40% of the deals have resulted in strengthened employment guarantees. In Poland, Price Waterhouse involvement in the Sandomierz Glass Company resulted in the development of a \$1 million retraining fund for displaced workers. Finally, Deloitte & Touche's work on ancillary assets in Poland has resulted in a format and pilot program for privatizing social assets (e.g. kindergartens, theaters, housing, etc.). This model should help future companies in developing strategies that are efficient and not disruptive.

These programs suggest that AID can play a positive role, particularly at the negotiation stage with foreign investors, in developing programs and employment guarantees. Still, for the next stage of privatization-- i.e. dealing with domestic firms and bankruptcies-- AID will face an unprecedented number of social issues, most of which will not require significant resources to address.

In dealing with social issues and unemployment, AID will have to weigh different approaches, none of which are necessarily exclusive of one another. One approach would be to focus on developing privatized social programs or a government approach for providing social services. This approach would include assistance being considered by AID in the Czech Republic for privatizing the health sector.(see Section 2.2.6.1 for details).

Another approach would be to focus on helping domestic firms to survive, thereby reducing the likelihood of massive layoffs and decrease in tax revenue. There are three areas in which AID could focus its efforts: 1) technical training, 2) management of debt and development of new credit, and 3) development of regional and export markets. All of these are overwhelmingly needed, but it is difficult to say where and how AID might focus its resources.

AID assistance could be used to identify and develop pilot programs in industry sectors that meet the following criteria: provide "basic needs" goods, have certain trade relationships, have some capable firms and are labor intensive. Of course, the risk of this is similar to the risks encountered in other sector approaches -- high upfront costs, disparate political support and uncertain firm commitment.

AID could also help to develop broad programs -- such as export promotion or seminars on strategies for managing debt -- that would be available to those firms that are interested and willing to follow through on new initiatives. This approach might be more cost-effective and politically more appealing than an industry approach.

A third area of support which would help domestic firms would be to extend and expand the macro-level debt restructuring work being undertaken by KPMG in Hungary to Poland and the Czech Republic as necessary. The purposes of this effort would be to (a) have the governments consolidate publicly created debt outside the current banking system, (b) rebuild a banking system that can lend effectively to privatized firms. One particular approach would be to combine a bankruptcy reform initiative with a macro policy that reduces interest rates to privatized firms, thereby reducing their debt burden.

Finally, any preparations made to provide training to conserve employment in privatized firms should involve leverage. As noted above, the need should depend on the actions of other donors such as PHARE and USAID's priorities for certain economic sectors. Preparations should involve leveraging USAID's resources through existing programs such as the:International Executive Service Corps,MBA Enterprise Corps, and the Peace Corps Free-Enterprise Transition Consortium.

4.2.3 Gender Impact

The evaluation scope of work asks whether there is a need to raise the sensitivity of host government officials and private sector counterparts to issues of gender equity. It also asks what the gender impact has been of current privatization experience.

Evidence from interviews indicates that gender equity issues are not a major concern of government officials or private sector companies. In most cases, managers did not base their decisions on the basis of gender. Also, none of the government officials had analyzed or formulated opinions concerning the role of women in privatization or the impact the process had on women.

This is not to suggest that women might not be disproportionately affected. Anecdotal evidence reveals a mixed picture on the role of women in privatization. In the Czech Republic, the managers of two privatized companies mentioned that the technology transfer that occurs after privatization (particularly when there is a foreign investor) typically "requires" the services of men, rather than women, to manage new production lines. In another case in Hungary, a manager mentioned that some of the easiest cuts in staff can be made in the administrative office where there may be more secretaries and support staff that are women and not needed. On the other hand, interviews in Poland show that women are on the worker's councils and play a role in deciding the future fate of companies.

In view of the lack of official statistics and overall lack of host country concern for the issue, it will be necessary for AID and other donors to examine these issues in more detail so that, together, they can map out a strategy for assisting population groups affected by privatization. This would apply to the displaced labor force in general, as well as to women in particular.

4.3 Proposed Indicators for Future Monitoring of Impact

Clearly there is a need to improve future monitoring of privatization activities. In order to provide timely and meaningful management guidance, any proposed indicators should be easily: definable, obtainable and attributable.

With limited staff resources, it is essential that monitoring information be relatively easy to define and collect. Management needs information that can be collected on a timely basis. They also need to know that the information collected is relevant, and most importantly, somehow related to program objectives.

In AID project design parlance there are essentially two key levels of indicators that can be monitored. The highest level are "goal" related indicators which track developments at the macroeconomic level, and if possible, try to define the impact of AID assistance in the context of country wide developments. Some possible indicators include:

1. % of GDP in Private Sector
2. % of Employment in Private Sector

These indicators are useful to show whether AID is contributing to a positive or negative macroeconomic trend. They are also inexpensive to collect. But they rarely can be directly

attributable to AID assistance. The larger the economy the more unlikely it is that AID assistance will be large enough to significantly affect macroeconomic trends.

The next level down in project design, and the level which is most attributable to AID managers are "purpose-level" indicators. These indicators are intended to directly measure the impact of AID assistance. Some recommended indicators would include by type of assistance:

"Bottom Line", Top Five Indicators:

1. Number of Privatizations (including spinoffs from companies)
2. Increase in investment (foreign and domestic)
3. Maintenance/Expansion of Employment
4. Increase in revenue
5. Level of environmental liabilities

Other Indicators by Type of Assistance would include:

Policy/Program Support:

1. Number of new policy or program initiatives established
2. Percentage of Bad Loans Worked Out/Renegotiated

General Institutional Support:

1. % Turnover
2. % Trained Personnel
3. Processing Time Required to Complete Privatization-related Procedures.

Training:

1. Level of technical assistance (in days, months or years)
2. On-time Completion Percentage of Training %
3. Attendance Percentage
4. Appraisals (Participant, Supervisor)
5. Job Skills Change

Firm-Specific Assistance:

1. Change in Corporate Governance
2. Change in productivity
3. Return on Assets Employed
4. Change in Sales (domestic and export, by country, by product mix).
5. Change in debt/equity ratios

The selection of which indicators to track will vary from country to country.

5. LESSONS LEARNED AND FUTURE STRATEGIC IMPLICATIONS

Our findings reveal that AID assistance has been most successful in developing the institutional and financial structures required to facilitate future privatization transactions. More problematic has been assistance to individual enterprises.

AID assistance was most effective in projects in which there was:

- a) a clearly defined bottleneck or lack of clearly defined policies
- b) strong host country government support from the outset
- c) clearly defined end objectives .

These and other success factors are described below:

*** Policy/Program or Institutional Support Oriented:**

It is most cost effective to focus on policy/program and/or institutional support. Conversely, our most surprising finding was that firm-specific, transaction-oriented assistance has a low success ratio and is generally not cost effective.

*** Focused Towards the Middle or End of the Privatization Cycle:**

The more successful projects are undertaken in the middle of the privatization sequence or towards the end. Projects undertaken at the beginning are often subject to floundering and have a low success rate because the targets are scattered. The problem with avoiding these early stages is that there is stronger merit and impact associated with getting in on the ground floor of a new program.

*** Clearly Defined Objectives:**

We found that projects that are precisely focused as to their objectives are more likely to be successful.

*** Strong Government and AID Support:**

Successful projects have clear government support. The Government is willing to act without letting other factors - usually political - interfere. In addition, support from AID/Washington and the local AID/Rep is well coordinated and flows smoothly without disruptive starts and stops.

5.1 Lessons Learned

It is interesting to note that the most successful projects, with few exceptions, began 6-9 months after the Privatization IQC contracts were started. Most of the early investments in sector studies or firm-specific transactions were either inconclusive or mixed in their results.

It seems that with experience, AID was able to self-correct a lot of the initial problems it encountered in its initial year. Increasingly, AID assistance shifted away from firm-specific transactions to policy/program support and institutional support.

Some lessons learned regarding AID management, portfolio and project strategy, project design and project implementation are mentioned below.

1) AID Administration

- * The IQC mechanism was designed to mobilize AID resources quickly for undefined future activities. In practice, it has not been timely, nor necessarily an appropriate instrument for providing long term technical assistance. This was due in part to:

- IQC contracts are best suited for short-term, discrete activities controlled by the field. IQC contracts are not well suited for longer term technical assistance or mobilization of equipment and other non-personnel resources. Typically, IQC work orders have not been used by AID for purchasing equipment or contracting technical advisors for more than three months.

- Decisions on project details are too centralized in AID/Washington. Communication and agreement on objectives and priorities was often lacking between AID/Washington and the field. AID/Washington seems to lack both a sensitivity for host government needs and a sense of urgency in responding to requests from the field. This was exacerbated by the fact that AID/Washington has been understaffed, suffered from staff turnover, and has not always had the funds necessary to manage the program.

- * The lack of a well defined, coordinated contract administration causes delays in project work flows which jeopardize credibility with the host governments and in the consistency of work performance.
- * Country strategies are more appropriate than regional strategies because of each country's historical differences, its economic capabilities, and the social and political attitudes which have resulted from the diverse privatization paths followed by each country.

In some areas, however, it is possible to leverage AID experience gained in one country to a program in another. This is particularly true for assistance in mass privatization, financial sector reform, and training.

2) Privatization Strategy

- * In a "bottom-up" privatization in which the government adopts a laissez-faire, decentralized approach and companies are left to their own initiative to privatize, it is important to put in place procedural and regulatory safeguards. In particular, this applies to the Czech Republic.

In a "top down" process in which governments are more involved in selecting and privatizing companies, it is important to make sure that procedures are efficient and based on technical criteria, thereby ensuring that processes are not politicized. This applies to Poland and Hungary.

- * An ad hoc, reactive privatization strategy - in which program initiatives are defined by government demands and/or marketing efforts of contractors - can help generate political support and goodwill. It also can be useful for testing a variety of experimental interventions.

However, the continued application of an ad hoc, "buckshot" strategy can eventually lead to dissipation of resources, and in the absence of concrete results, a weakening of political support for a program.

- * The privatization process can be viewed as a two stage process. In Stage I, it is important for governments to establish **credibility** (e.g. register some "success stories"), **consistency** (have procedures in place) and **transparency** (establish a fair and understandable operating environment). AID has been successful in developing the first two objectives -- credibility and consistency; it has been less effective in establishing transparency, and related to this issue, in clearly defining the responsibilities and relationships between government agencies.

Stage II (which the three countries are now entering) is full of challenges. It will require a programmatic emphasis on: restructuring/corporate governance, bankruptcies, and effective training programs. A major challenge is how should AID assist middle-tier, struggling companies.

3) Project Design

- * AID has to be responsive to the priorities of a host government. However, having governments set the rules for project conduct is not always a reliable guidelines governments have too many mixed agendas.

Being responsive is only useful when it is timely.

- * Donor coordination at the project design stage has not been strong. Up to now, this has not been a major disadvantage to country privatization programs. Nevertheless, there should be greater complementarity among the different areas funded by the various donors.
- * Project emphasis on foreign investors can produce quick, short term economic benefits, but this should not be carried to the point that domestic issues and constraints are overlooked (e.g. restructuring, promotion of domestic investment, etc.).

4. Project Implementation

- * With a few exceptions, the technical competence and acceptability of the work performed has been good. When compared to the work of other donors, this professionalism has resulted in a "good image" for the U.S. government.
- * AID is best at "facilitating" privatization processes rather than "promoting" one particular privatization transaction. Industry specific, "promotion" activities are resource intensive and take longer to achieve their objectives than facilitation activities.

We should avoid direct involvement in firm-specific transactions, especially if they are large and complex and appear to be "no win" situations.

The sectoral approach is not cost effective and contains no particular advantage. AID should try to avoid trying to pick "winners" by carrying out long detailed market and firm-specific analyses.

- * Long term advisors are a useful mechanism if they are expertly staffed and if the host government clearly wants them and listens to them. They are particularly useful when focused on a particular critical sector or a clearly defined activity.

5.2 Proposed AID Assistance Strategy

In the future, AID will need to be more selective in how it targets its assistance. Country strategies should be developed with annual funding targets, clearly defined priorities and objectives, yet still be responsive to host country requests. Being responsive, however, does not mean becoming laissez-faire "demand-driven" or allowing contractors to market new initiatives without guidance.

To the greatest extent possible, AID should try to leverage its resources by:

- * Transferring the successful experience in one project from one country to another -- this would be appropriate for the Crimson Capital/D&T work as well as the financial sector development going on in Poland and Hungary.

- * Expanding into new services and types of assistance by building off assistance to existing institutions -- e.g. development of new workout units in the Czech Savings Bank.
- * For new initiatives, financing small "seed" projects in new experimental privatization methodologies-- e.g. like the Self-Privatization or ESOPs projects.
- * Closely coordinating with other donors, particularly in the area of training and in high risk areas of assistance like social programs and restructuring.

For privatization assistance in any country, AID should attempt to follow these broad guidelines:

- * **Minimize Unnecessary Management Risk Factors:** Unknown market and political forces make privatization assistance a risky business. It is essential to minimize project management risk by clearly defining project objectives, thus ensuring that government officials and all AID parties agree on the objectives, and then developing appropriate procedures for supervising and funding project activities.
- * **Decentralize Program Management:** The AID/representative should be responsible for the day-to-day management as well as the overall approval and funding of contracts. AID/Washington should serve as a regional clearinghouse that provides technical support to country programs. Of particular importance, AID/Washington should assist in transferring elements of a successful program in one country to other countries in the region.
- * **Leverage Existing Resources:** AID should expand into new activities by building off existing successful programs.(e.g. initiation of a bank workout unit in the Czech Savings Bank.) For completely new programs, AID should keep its resources focused on one institution and/or on one clearly defined activity or program objective.
- * **Develop More Focused, Structured Training Programs:** Training is an effective form of privatization aid providing it is focused, is job-related, and conducted principally on-the-job. We should leave formal, generalized classroom-style training to other donors, except where the content is uniquely related to American experience. (e.g. SEC type regulations, ESOPs.)

5.2.1 Types of Assistance to Continue or Expand

AID should continue its assistance for facilitating negotiations with foreign investors (e.g. Crimson Capital/D&T), developing financial institutions and policies, supporting mass privatization, and assisting new privatization methodologies -- e.g. ESOPs and Self-Privatization in Hungary.

For a detailed list of types of assistance to continue or expand, refer to country-specific recommendations in Sections 5.3.1 through 5.3.3.

5.2.2 Types of Assistance to Discontinue or Postpone

Firm-specific transactions and sector studies tend to be costly and should be discontinued or postponed. Sector studies take a long time to achieve their objectives, in part because the assistance takes place too far "upstream" with general analysis, identification of partners, etc. While these studies may eventually reach their goals, institutional patience has often worn thin and new more immediate needs have developed.

Specific examples include:

Czech Republic: Metallurgy "sector", Management contracts, and Skoda-Pilsen.

Poland: LOT Airlines (although this still might prove to be a success) and Privatization through restructuring.

Hungary: Monor State Farm and Quick-Form pilot privatizations

Also on this list is the discontinuation of a long term advisor in the SPA (after the current contract expires in September 1993). While this project was successful in achieving its objectives, the advanced level of institutional development precludes further funding of a long term advisor.

5.2.3 New Initiatives or Complementary Assistance

In the future, AID will need to focus its efforts on bankruptcy/workouts, provide more structured on-the-job training, and expand its training activities in institutions currently receiving assistance (e.g. Czech Savings Bank, Ministry of Privatization). Where possible, it should also actively solicit and try to leverage its programs off additional donor resources. This was done successfully in Hungary working with the PHARE, and could be further promoted in all three countries.

In addition, all three countries might be in need of public awareness and information campaigns. These might be required to ensure that privatization programs do not become derailed due to uninformed public distrust. Also, each country should look to develop a monitoring system for tracking foreign investment commitments and, if possible, identifying training needs and the impact of privatization on various social groups.

Finally, as initial foreign investment wanes and the better domestic companies are bought, AID might develop a targeted investment and export promotion program. Such a program would focus on finding new markets for domestic producers and on bringing in new capital and technology.

5.3 Country Specific Strategies

5.3.1 Czech Republic

- * Continue support to Crimson Capital/D&T into 1994. If requested, expand operations into the National Property Fund.
- * Continue training program in Czech Savings Bank (CSB). Focus on developing more structured training.
- * Increase involvement, as appropriate and requested, in the voucher program.
- * Initiate assistance for bankruptcy issues.

5.3.2 Poland

- * Continue "back office support" for the MPP.
- * Expand financial sector policy and program reform.
- * Curtail involvement in future individual transactions and sectoral work. New transactions should not be initiated, but on going transactions should not be cut off.
- * Initiate assistance for bankruptcy issues.
- * Provide additional Securities Commission support if requested
- * Continue assistance for privatization of municipally owned companies (determine if this can be done in other countries).
- * Determine feasibility of Institutional Support for the Ministry of Privatization.

5.3.3 Hungary

- * Continue support for financial sector development.
- * Provide limited support for new privatization methodologies (IMPACT project).
- * Determine need to support Mass Privatization if it is approved.
- * Expand support to the Self-Privatization program.
- * Initiate involvement in bankruptcy issues.
- * Do not extend existing long term technical assistance contract in the SPA, with its continued emphasis on general institutional support.
- * Refocus SPA support towards facilitating privatization closings. If a transactions unit is set up, it should closely work with Hungarian counterparts, and on both foreign and domestic investments.
- * Determine possibility of a long term advisor in the Ministry of Privatization, the Ministry of Finance or the State Holding Company (AVRT). This should be done only if the government wants an advisor and his area of expertise is clearly defined.

5.3.4 Southern Tier and Baltics

In the Southern Tier and Baltic countries in which privatization development is not as far along, AID should be able to transfer the concept and skills developed in its institutional support

and policy/program support initiatives developed in the Czech Republic, Poland and Hungary.

In "Stage I" countries just beginning their privatization programs, AID's overriding objective should be to establish **credibility** by helping push through to privatization some of the stronger firms that might still face significant bureaucratic delays; **consistency** by establishing general institutional procedures and processes for facilitating privatization; and **transparency** by helping establish the financial sector and an appropriate regulatory and legal framework.

Also, financial sector support should begin sooner, with particular emphasis on controlling inter-company debts and developing work out procedures for existing bad loans held by the banks.

5.4 Future Issues

In the future, AID will have to be concerned with a variety of potential issues. Past experience shows that AID support can inadvertently run into several potentially conflicting objectives. For example, in the Czech Savings Bank there is the potential conflict of having a savings bank handle investment funds. The U.S Savings & Loans experience suggests that AID should be careful in overextending the objectives of banks, particularly one that is just learning the ropes of managing assets in a market economy. Furthermore, there is the issue of how much AID support should be focused on one, "private" institution. Public funds should be ideally focused on helping all private institutions to prosper and compete fairly. By providing assistance to one institution like the CSB, AID runs the risk of being accused of providing unfair subsidies.

Other issues that require additional consideration by AID include:

1. **Cost-sharing** -- Perhaps AID should begin charging companies for assistance rendered. This is most appropriate for firm-specific assistance in which AID must select one firm over another. Such procedures could help in promoting greater self-sufficiency, and decreasing dependence on donor funding for future programs.
2. **Success Fees** -- The Self-Privatization experience in Hungary suggests that success fees can be a powerful incentive to attract private management companies. Also, success fees have been used in the Sectoral Studies in Poland and the voucher program in the Czech Republic. On the otherhand, the "privatization through restructuring" project in Poland has still been unable to contract companies based on a success fee to help restructure companies. This issue should be experimented with as a means to decrease AID obligations.
3. **Inter-Company Debts** -- This is a huge problem that will affect all three companies. To date, no country has developed a successful policy for handling inter-company debts.

4. Bankruptcy and Workouts -- AID needs to develop an effective strategy for dealing with this large and pervasive problem. Different approaches to this issue should be carefully monitored.

5. Gender and Other Social Impact Issues -- There is very little information on the impact that privatization programs have had and will have on women and other groups in society. AID should develop a better understanding of these potential issues and examine future strategies for dealing with them.

APPENDIX 1

EVALUATION SCOPE OF WORK

Scope of Work, Evaluation of Privatization and Enterprise Restructuring Project (180-0014)

The Consultant will provide an assessment of the impact and effectiveness of AID's Privatization & Enterprise Restructuring Project (180-0014) in the CSFR (the Czech Republic), Poland and Hungary. This builds on the ongoing, Phase 1 assessment of country privatization progress in these countries under the Price-Waterhouse study, Privatization in Central Europe, A Preliminary Assessment, September 1992. To date, a total of \$43.7 million has been obligated for project 180-0014.

BACKGROUND

As of September 25, 1992, 43 projects in 10 countries (at a cost of about \$37.5 million) have been approved. (See ARTI monthly status report, Sept. 25, 1992 this project, page 26). A number of these have been completed with final or progress reports available for review. (Please refer to DELIVERABLES below.)

Over 2 years have passed since the initial obligation of funds for this activity. While the broad, regional approach was the agreed strategy at the time to address targets of opportunity, a readjustment of the project to meet country-specific requirements may now be in order. It is also important at this juncture to identify the elements of AID assistance which have had positive impact and establish the means to measure them. (See TASKS below.)

Since the Contractor will not have time to examine all of the completed or ongoing activities in the region, the Team will concentrate on the three major recipients of AID resources: the Czech Republic of the CSFR, Poland, and Hungary. AID activities in these three countries are the most advanced, and the Contractor will utilize the valuable information assembled under the Phase 1 country progress assessment. (See below.)

TASKS

The mutually reinforcing purposes of the Economic Restructuring/Privatization project are: a) to assist Eastern European governments in establishing the legal and institutional framework for privatization, and b) to assist individual firms in strengthening management and adjusting to open, competitive markets.

The Contractor's overriding objective is to examine the range of approaches utilized by AID in this sector -- from policy advice at the ministerial level to assistance to individual enterprises -- and assess their impact country-by-country. At this stage in project implementation, this information is crucial in order to concentrate AID assistance if, and where, it may be necessary to do so.

Within this overall objective, there are three main elements to this evaluation. First, the Consultant will identify the

positive and successful elements of AID assistance to date along with quantitative and qualitative indicators (foreign investment, changes in real wages, for example) to measure progress. Secondly, the Consultant will examine the lessons learned in the region from the Phase 1 Sector Assessment to determine if AID assistance should be redeployed or reallocated in certain countries. (For instance, in cases where large scale privatization is blocked, should AID concentrate on the privatization of small enterprises?) Third, the Contractor will highlight those portions of AID support in the Northern Tier countries that are applicable to the Southern Tier and Baltic countries.

The specific issues/questions that the Contractor will address are grouped into 2 categories: a) general, to be answered for each country; and b) specific to one particular country.

A. General issues

1) Identify and evaluate the trade-offs between 4 alternative approaches for AID support: a) assistance with individual privatization transactions; b) assistance at the policy level; c) assistance to indigenous public and private entities engaged in facilitating privatization; and d) assistance more linked to follow-on enterprise development (monitoring, training, etc.).

2) Evaluate the processes by which assisted enterprises were selected. Develop quantitative and qualitative measures of impact and test them against the enterprises targeted for assistance. Identify cases in which country objectives conflict, e.g. objectives of maintaining or expanding employment vs. restructuring or liquidating enterprises; or accelerating the pace of privatization vs. maximizing revenue to the Treasury. Assess how such conflicts were resolved in the type of assistance delivered. Evaluate the concern that the most attractive enterprises have already been sold, and assess assistance strategies designed to dispose of the bulk of large-scale enterprises which cannot be sold quickly. Assess the objectives and progress of AID's grant to the IBRD that was designed to establish an analytical framework for selecting enterprises to be privatized. Recommend ways in which enterprise selection criteria and types of assistance should be reoriented, if necessary, to increase the impact of project funds.

3) Through ministry and firm interviews, assess the categories of trained host country personnel available in the private sector and as candidates for employment by the newly created government privatization agencies. Identify categories of business development and privatization skills in which gaps persist, limiting the speed and success of privatization. Recommend skill categories that should receive more emphasis in AID-financed training (short- and long-term, in the privatization project and in regional training projects). Where trained personnel are available, but not retainable in the public sector (e.g. in view

of wage and benefits differentials), recommend the appropriate mix of private and public assistance for the deployment of AID privatization and related training resources. For example, within the constraints of resources and staff, should the training in skills involved in privatization -- accounting, marketing, finance, banking, administration -- receive higher priority?

4) Assess impact from experience to date in AID collaboration with the IBRD, EBRD, EC, IFC, and other donors in specific privatization ventures and related policy assistance.

5) Given the rapid changes in the region, assess whether AID assistance should be demand driven. This means more resources will be earmarked for Poland. Assess this against the host country concern that AID assistance has been supply-driven, i.e., by contractors and AID officials.

6) Based on our experience with SPA in Hungary, at what level and to what extent should AID pursue major technical assistance and training support for key privatization agencies? Assess experience to date to determine whether there is a risk that such support will be counterproductive (e.g. could slow the pace of privatization) by strengthening vested interests within the agencies for maintenance of a continued role in the economy (e.g. becoming or spinning off state holding companies). Does country-specific institutional framework pit production ministries against the privatization ministries?

7) Is there a need for AID to do more to raise the sensitivity of host government officials and private sector counterparts to issues of gender equity? Assess the gender impact of current privatization experience (e.g. land privatization legislation precluded female inheritance of land in Albania, employee stock ownership plans have gender impacts in the context of male/female labor force patterns within industries, etc).

B. Country-specific issues

CSFR (Czech Republic)

1) In the context of country-level opportunities and constraints in voucher privatization, and impacts on enterprise management and individual asset holdings of voucher trading, assess whether AID should start to support development of capital markets, and the likely impact of alternative ways of providing this assistance, for example, by providing assistance to the State Savings Bank (manager of the largest voucher stock fund) and other holding companies.

2) Identify and document the lessons learned from CSFR success in attracting foreign investment, assess the complementarity of AID's assistance to the voucher program, and examine the

conditions under which these lessons are transferable to other countries.

3) The lack of clear tax liabilities due to each level of government has reportedly been a disincentive to foreign investment in privatization. Assess the severity of impact of this and other disincentives, and recommend whether (and if so how) AID technical assistance to fiscal reform should be strengthened to address this bottleneck (outside of this project if necessary).

POLAND

1) In view of the political appeal of indirect privatization, and its economic benefits, assess the need to support aspects of Poland's mass privatization program beyond the current "back office" support for share transfer custodianship, depository functions, and shareholder relations. Evaluate whether AID financing should be used to assist in the operations of the new investment funds.

2) Assess the quantitative and qualitative impact of AID assistance on reducing barriers to foreign investment in the Polish policy/regulatory environment. Identify policy/regulatory areas that require intensified technical assistance. In this connection, assess likely impact of AID support to IRIS -- which works on more precise laws to protect property owners.

3) Assess whether AID assistance to the GOP to improve the efficiency of Boards of Directors of SOE's would accelerate the privatization process. Evaluate the proposed program for "privatization through restructuring."

4) Should future AID assistance concentrate more on the financial sector, specifically, the privatization of banks and their loan portfolios? Evaluate the impacts to date on assistance absorption caused by the "sequencing problem" of the need to privatize both state-owned enterprises and the financial sector.

5) What are the lessons learned from AID assistance to the Huta Warszawa Steel Mill and LOT airline? Evaluate the requests for this assistance and the appropriateness of AID intervention in these two state-owned companies.

6) Should AID provide support for the privatization of municipal firms which can be transferred to the private sector without central government approval? Should AID provide assistance to the program of "privatization through liquidation"?

HUNGARY

1) Is the decision to end AID support of the SPA at the end of FY 93 sound? Examine German plans for privatization of much of

Trenhundanstaldt's activities by that time as a model, and assess its applicability to the Hungarian context. Assess the effectiveness of the SPA as the principal GOH privatization player. Are there other alternative institutional players with which AID could work to accelerate privatization?

2) How many SOE's have actually been privatized as a direct result of AID's assistance to individual privatization transactions? What has been the total revenue from those sales, total employment saved or generated, total foreign investment attracted, value of new trade relationships established, etc.?

3) Is the AID policy of establishing transaction units within banks likely to speed the process of privatization? Would impact be greater if transaction units with industrial specialties were created?

4) Examine proposals for technical assistance in the liquidation of SOE assets in cases of insolvency, and compare the cost effectiveness and impact of such assistance with alternative assistance strategies, e.g., assistance to emerging new private sector business.

METHODOLOGY

At a minimum, the Contractor will interview staff of the following organizations:

AID project managers and staff in the three countries
Representatives from other international and bilateral donors
Foreign and local buyers, local and foreign banks
local groups involved in privatization, such as ESOP in Hungary
Agency for Foreign Investment and Cooperation CSFR
Min. of National Property Administration and Privatization, CSFR
Officials of the SLIVER, KOLI, CREMONA, HOLICE and PETROF Cos., CSFR
State Property Agency, Hungary
Ministry of Privatization, Poland
Anti-Monopoly Office, Poland
Ministry of Finance, Poland
Warszawa Steel Mill and LOT airline, Poland

The Contractor will establish criteria for selecting a sample of firms to be interviewed in each country, to include those that have been privatized with AID assistance, and those that have been privatized without AID assistance, and firms that unsuccessfully attempted privatization with and without AID assistance. Contractor criteria for sample selection must be submitted to EUR/PDP and EUR/RME for concurrence prior to their use. At a minimum, the sample will include: a) a sample of small, medium, and large firms, and b) firms located both inside and outside of the capital city.

The Contractor will field a four person team, including a macroeconomist expert in privatization policy (serving as Team Leader), and three business management/restructuring experts with combined experience in training, privatization, political science/sociology, and finance. One or more team members should also have development program management experience. The Contractor will employ up to 2 local hires in each country to arrange interviews, handle logistics, and provide information. The Team leader will spend 5 days in Washington, starting on or about January 25, 1993, for briefing from AID/W, contractor staff, and other donors, prior to departure. Other team members in the Washington D.C. area will join the Team Leader for the last 2 days, if possible.

The four person team will spend one week each in Hungary, Czech Republic, and Poland, beginning not later than February 24, 1993. In the first country visited, the team will develop and test the prototype interview schedules and evaluation methodology to be employed in the remaining two countries.

DELIVERABLES

Prior to departure, Contractor will submit a draft work plan to EUR/PDP/PA for concurrence.

The Contractor will propose measures for testing the impact, effectiveness and efficiency of assistance delivered and test them against the cases sampled.

In the light of documented support to date, the Contractor will outline an AID assistance strategy in privatization and restructuring for each of the three countries. Based on this, and in the context of concentrating AID's privatization resources, the Contractor will: a) recommend types of assistance that could be continued or expanded in each country, based on sample findings; b) identify types of assistance that could be discontinued or postponed; and c) where appropriate, recommend new initiatives or complementary assistance to be undertaken.

The Contractor will also specify conditions under which the recommendations may be applicable to the Southern tier and Baltic countries.

Immediately after return from the field, draft summary findings and conclusions will be submitted to EUR/PDP/PA (i.e. draft Executive Summary). A draft final report will be submitted not later than March 24, 1993 for AID/EUR review. AID's comments will be given to the Contractor on or about April 7, 1993. Twenty-five copies of the final report, not to exceed 100 pages (with an Executive Summary of findings and conclusions not to exceed 10 pages) will be submitted by April 15, 1993. Additional material may be submitted in Annexes, if necessary.

DOCUMENTS

EUR/PDP will provide the team with the following background material: Project paper, Eastern Europe - Economic Restructuring, dated August 3, 1990; latest ARTI monthly report on Privatization and Enterprise Restructuring Project; Privatization in Central Europe, A Preliminary Assessment, September 1992; final reports for the following completed activities: State Property Agency, Hungary (PIO/T 1183479); Monor State Farm, Hungary (PIO/T 1183495); Huta Warszawa Steel Mill, Poland (PIO/T 2622105); Ministry of Privatization, CSFR (PIO/T 1183110); Solid Waste Management Services (PIO/T 1183497).

Privatization Phase 1 Country reports are also available. Phase I evaluation findings will be available in draft by January 4, 1993.

APPENDIX 2

**LIST OF PIO/T WORK ORDERS FOR THE
CZECH REPUBLIC, POLAND, AND HUNGARY**

LIST OF PROJECTS COMPLETED AND IMPLEMENTED

CZECH REPUBLIC:

YEAR	PIO/T #	TITLE	\$ AMOUNT	CONTRACTOR
1991	1183485	Czech Technical Assistance	\$1,689,820	PW
	2622100	Municipal Solid Waste Collection	\$280,388	PW
1992	1183108	TR to Ministry of Economics for MGMT Contracts	\$72,530	KPMG
	1183110	Czech Ministry of Privatization Phase I	\$479,250	D&T
	1183489	Skoda Pilzen	\$500,000	IFC Grant
	1183492	Koli Fruit Processing	\$101,600	C&L
	1183493	Cremona Instruments	\$81,350	D&T
	1183494	Petroff Pianos	\$79,261	D&T
	1183496	Util/Telecom Sector Studies	\$683,200	D&T
	1183498	Sliver Machines	\$82,430	C&L
1992	2622106	Ministry of Privatization Phase II	\$4,585,000	D&T
	2622107	Non-Ferrous Metal Company	\$710,350	KPMG
	2622108	Czech Savings Bank	\$1,815,880	KPMG
	2622125	TA to Czech Ministry of Economic Policy	\$133,510	KPMG
	2622125	Amendment Czech Ministry of Economic Policy	\$99,710	KPMG
	2622138	Czech Mass Privatization Phase III	\$2,000,000	D&T

LIST OF PROJECTS COMPLETED AND IMPLEMENTED

POLAND:

YEAR	PIO/T #	TITLE	\$ AMOUNT	CONTRACTOR
1991	1183490	TA for Privatization	\$2,204,486	PW
	2622103	LOT Airlines Privatization	\$762,100	D&T
	0183479	Technical Studies	\$210,000	Wharton
	1183476	Economic Restructuring/Privatization	\$183,841	Wharton
	1183477	Task Force Company Assistance	\$125,000	UNDP
	2622105	Huta Warszawa	\$106,533	C&L
1992	2622104	Bank Regulation and Supervision	\$446,030	KPMG
	2622110	Regulated Investment Companies	\$420,920	KPMG
	2622113	SEC Assistance	\$478,000	D&T
	2622114	Ancillary Assets Privatization	\$656,800	D&T
	2622120	Regulated Investment Companies II	\$495,000	KPMG
	2622121	Wood Products & Furniture Sector I	\$1,300,035	KPMG
	262122	Glass Sector Privatization	\$1,415,430.16	PW
	2622131	LOT Airlines Phase II	\$310,100	D&T
	2622132	Privatization Through Restructuring	\$342,660	D&T

LIST OF PROJECTS COMPLETED AND IMPLEMENTED

HUNGARY:

<u>YEAR</u>	<u>PIO/T #</u>	<u>TITLE</u>	<u>\$ AMOUNT</u>	<u>CONTRACTOR</u>
1991	1183479	Incremental Fund	\$299,700	D&T
	1183482	Contract Extension	\$2,477,197	D&T
	2622101	State Farms	\$686,680	ACDI
	2622111	Investment Promotion	\$468,997	D&T
	0183478	Economic Restructuring/Privatization	\$200,000	Scientex
	1183480	Monor State Farms	\$180,760	Chemonics
	1183495	Monor Farm	\$83,921	C&L
1992	2622112	ESOPS Program	\$423,758	C&L
	2622115	Quick Form Pilot Privatization	\$117,675	D&T
	2622133	COMPASS Project	\$293,820	C&L
	2622135	Franchising Privatization	\$249,829	D&T
	3622071	Financial Sector Redeployment	\$327,790	KPMG
1993	3622073	Amendment SPA Chick Twyman	\$1,425,480	D&T

APPENDIX 3

LIST OF PEOPLE INTERVIEWED

LIST OF PEOPLE INTERVIEWED
(In Alphabetical Order)

I. WASHINGTON, D.C.

A. A.I.D., Bureau for Europe

1. Kams, Mark -- Chief, Privatization and Finance Division, Office of Economic Restructuring, Regional Mission Bureau
2. O'Farrell, Paul -- Director, Office of Program Development and Planning
3. Prindle, Deborah -- Chief of the Program Office of Program Development and Planning

B. Contractors

1. Davis, Robyn C.-- Manager, KPMG Peat Marwick
2. Leeds, Roger -- KPMG Peat Marwick
3. Mastranangelo, Teresa B.-- Deloitte Touche Tohmatsu International
4. McPhail, Robert, J.F. -- Deloitte Touche Tohmatsu International
5. Rourke, Robert -- Coopers & Lybrand
6. Waddell, James -- Price Waterhouse
7. Warman, Arthur -- Deloitte Touche Tohmatsu International

II. CZECHOSLOVAKIA

A. USAID

1. Rogers, John. -- Private Sector Officer
2. Roussel, Lee -- AID Representative

B. Contractors

1. Coleman, Jeremy -- Price Waterhouse
2. Cromack, John -- Coopers & Lybrand
3. Drayton, Catherine -- Manager, Coopers & Lybrand
4. Dube, Alain -- Deloitte & Touche
5. Farmer, Ran -- Senior Manager, KPMG Peat Marwick
6. Haswell, Carleton -- Senior Manager Banking, KPMG Peat Marwick
7. Hraska, Gustav -- Partner in Charge, Deloitte & Touche
8. Keith, Alistair -- Crimson Capital
9. Kwan, Clarence -- Partner, Deloitte & Touche
10. Lister, Douglas -- Investment Officer, Corporate Finance Services, International Finance Corporation

11. Tischler, Peter -- Crimson Capital
12. Wallinger, Trevor -- Deloitte & Touche

C. Government Officials

1. Bukac, Mr. -- Czech Savings Bank Investment Privatization Fund
2. Curin, Mr -- Sprava Radiokumunukaci
3. Drake, Joseph -- Advisor, Ceska Sportelna a.s.
4. Hilsinger, Jeanne -- Senior Advisor, Center for Foreign Assistance, Ministry of Economy
5. Josefiova, Vladimira -- Ministry of Privatization Department on Foreign Investment
6. Klapal, Jaroslav -- Member of the Board of Management and Deputy General Manager and Member of the Board of Prague Stock Exchange, Czech Savings Bank
7. Petr, Vladimir -- Ministry of Industry
8. Princ, Jan -- Deputy Director, Fund of National Property
9. Rozsypal, Pavel -- Director, Center for Foreign assistance, Ministry of Economy
10. Stary, Lubomir -- Deputy Director, Ministry of Economy of the Czech Republic
11. Vlasek, Victor -- Senior Advisor, Ceska Sportelna a.s.

D. Companies

1. Ackerson, Sarah -- Advisor, Ministry of Finance of the Slovak Republic
2. Blazek, Jaroslav -- General Manager, Zelezarny Vamberk, a.s.
3. Douglas, Les -- Managing Director, Schindler
4. Hrusa, Vladimir -- Director of Finance, Barrandov Film Studios
5. Janda, Jiri -- General Manager, Prazska Cukerni Spolecnost
6. Kuderik, Mr. -- Vyahy Praha
7. Kula, Jiri -- Financial Manager, Zelezarny Vamberk, a.s.
8. Smolik, Mr. -- General Manager, Kovohute Rokycany

E. Others

1. Arbess, Daniel -- White and Case
2. Barta, Rudolf -- IESC
3. Gibian, Paul -- Czech & Slovak American Enterprise Fund
4. Kosman, Karel -- IESC
5. Richards, Whit -- Czech & Slovak American Enterprise Fund
6. Seipel, Alex -- Bankers Trust

III. POLAND

A. USAID

1. Anderson, Eve W.-- Private Sector Coordinator
2. Chen, Melanie Mamrack, Project Development Officer
3. Joslin, William -- AID Representative

B. Contractors

1. Baldwin, Jeffry, Partner, Deloitte & Touche
2. Bulkley, Jonathan A., Senior Advisor, KPMG Peat Marwick
3. Butt, John N., International Privatization Group, Price Waterhouse
4. Kester, James, Privatization Specialist, Policy Economics Group, KPMG Peat Marwick
5. Kurtz, Mariann, Senior Consultant, Policy Economics Group, KPMG Peat Marwick
6. Murdoch, Neil, International Privatization Group, Price Waterhouse

C. Government Officials

1. Adamkiewicz, Zbigniew, Director, Corporate Finance Division, KPW Polish Securities Commission
2. Fornalczyk, Anna -- President, Anti-Monopoly Office
3. Grzeiszczyk, Boguslaw -- Advisor to the Minister, Ministry of Industry and Trade
4. Kovacs, Gyorgy -- Managing Director, PRI-MAN (Privatization Management Company Limited)
5. Pietrzak, Rafal -- Project Manager for Trading Mass Privatization Program, Ministry of Privatization
6. Podgorski, Andrzej, Ph.D. -- Director, Ministry of Privatization
7. Repa, Antoni -- Supervising Project Manager, Mass Privatization Department, Ministry of Privatization
8. Sidorowicz, Jan -- Director, Department of Privatization Through Restructuring, Ministry of Privatization
9. Sleszynska-Charewicz, Ewa -- Director, National Bank of Poland
10. Tarnowski, Artur -- Project Manager, Ministry of Privatization

D. Companies

1. Bogutyn, Tomas -- Manager, Corporate Development Department, Polish Airlines
2. Katdumski, Krzysztof -- Managing Director, Czerskie Fabryki Mebli
3. Stansky, Paul -- Technical Director, Osan Praha
4. Sandomierz, S.A.
5. Zaklady Azotowe, S.A.

6. Two furniture companies (to be added)
7. Small mirror company (to be added)

E. Others

1. Laszlob, Dr. B.A. Alfred -- Senior Advisor, Foundation for the Development of the Financial Sector , EC/PHARE
2. Harder, Stephen -- Associate, White and Case
3. Hirst, Allen -- Director, Citibank
4. Nettekoven, Dr. Lothar -- Senior Advisor, Industrial Development Agency, Commission of the European Communities Delegation Poland

IV. HUNGARY

A. USAID

1. Cowles, David -- AID Representative
2. Project officers (to be added)

B. Contractors

1. Asmon, Itil -- Manager of Technical Services, Central and Eastern Europe, Chemonics
2. Benford, Stephen Y. -- Senior Project Administrator, Central and Eastern Europe Operations, Chemonics
3. Dewey, William M. III -- Advisor for Banking Reform, Prime Minister's Office
4. Morabito, Vincent -- Partner, Chemonics
5. O'Connor, Brian -- Advisor, Investment Promotion and Trade Agency
6. Twyman, Charles -- Deloitte & Touche

C. Government Officials

1. Hetzel, Martin -- Controlling-Berator, State Property Agency (SPA)
2. Janos, Both -- Director, Self-Privatization, SPA
3. Kazar, Peter -- Director, Compensation Notes Program, SPA
4. Koczian, Dr. Jozsef -- Economist, Ministry of Industry and Trade, Republic of Hungary
5. Kovacs, G. -- Manager, Pri-Man Ltd. (Self-Privatization)
6. Lajtai, Mr. -- Director of Transaction Methodologies, SPA
7. Lazlo, A. -- Manager of Privatization, Ministry of Finance
8. Lukacz, Dr. Erzebet -- State Property Agency
9. Lukacs, Janos -- Executive Director, SHARE - Participation Foundation
10. Morenth, Andras -- Advisor to the President/CEO on International Cooperation, Hungarian State Holding Company

11. Srilagyi, Mrs. -- Manager of Privatization, Ministry of Industry

D. Companies

1. Kostyal, Stephen F. -- Executive Director, Ganz-Hunslet, Rolling Stock Production

E. Others

1. Clark, Howard -- Commercial Attache, U.S. Embassy
2. Csikos, Istvan -- C&W Software KoG.
3. Czirjak, Laszlo -- General Manager, Bankers Trust Rt.
4. Eisenberg, David -- Associate, White and Case
5. Hughes, Patrick C. -- Assistant Commercial Attache, Embassy of the United States/Budapest, Hungary
6. Rogerson, Mr. -- World Bank
7. Thomas, Hon. Charles -- U.S.A. Ambassador to Hunngary

APPENDIX 4

**DESCRIPTION OF THE
TREUHANDONSTADLT PRIVATIZATION PROGRAM**

DESCRIPTION OF THE TREUHANDANSTALT PRIVATIZATION PROGRAM

A. The Treuhand Privatization Method

Treuhandanstalt is the German Government corporation in charge of privatization of SOEs inherited from Eastern Germany. We have been asked to comment on this model and its degree of applicability elsewhere.

B. Description of Treuhand

Treuhand has 3700 employees and is organized by industry. It is transaction-oriented; its object is to privatize the East German state-owned apparatus as rapidly as possible. As a first step, as of July 1, 1990, all SOEs were transformed and transferred to Treuhand ownership.

Treuhand's industry experts decide case by case on the disposition of SOEs based on a privatization plan required from each entity. This plan must include a listing of all likely acquiring prospects.

The Treuhand analyst instigates privatization negotiations immediately. In 95% of the cases it makes more than one contact, it being the initiator. The search for potential investors is active and is conducted with the help of a number of Treuhand offices all over the world. At first, sales were predominantly to West Germans, who were the only active buyers on the scene, but now it is worldwide.

A fresh valuation is made and decision taken on the disposition of liabilities. The alternatives are restructure, "silent liquidation" (liabilities paid off by the Government), asset sale, or declaration of bankruptcy. Contingent liabilities are set up in a reserve agreed upon by Treuhand and the buyer. Up to the reserve amount, the actual liability is absorbed 100% by the buyer. Beyond this the charge is shared but only up to a certain predetermined ceiling amount.

Government sets the price and other important conditions such as investment required and employment commitment. The Government may give guarantees and special rates as it sees fit. It can change the management if it judges that to be appropriate.

All basic decisions are made by Treuhand staffers and by them only, except that beyond a certain size enterprise they must be referred to top Treuhand supervision. Sometimes outside consultants are used, but not often. Occasionally there are success fees to outsiders. Managers of the subject SOEs are not present at the negotiations. 15% of the transactions have been MBOs.

Treuhand started with 9000 SOEs. After splits and separation of subsidiaries, this count became 12,500. 8000 of these have been privatized, 2000 have been liquidated and 2500 remain in the portfolio to be dealt with. Treuhand is scheduled to complete its work and go out

of business by the end of 1994.

C. Analysis of Treuhand and its applicability elsewhere.

1. The entire emphasis is on speed; getting the job done is paramount, even if many corners are cut to do it.

2. The accusation has been made that Treuhand has sold too low. This accusation so commonly accompanies privatization worldwide that it must usually be looked on with some suspicion. The German Government says this is not the case and we have not investigated further.

3. This is a very top-down, effective, but dictatorial approach to privatization to an extent that it is probably not politically replicable elsewhere. Treuhand has absolute authority over the transactions, with no appeal, no interaction, and very little transparency beyond publishing the end results.

4. It is also a very expensive way to solve the problem. The staff and the total cash outlay is enormous, although Treuhand employee salary cost is only .2% of the accumulated revenue to the state. Attitude to liabilities is to wipe the slate clean rapidly. Germany's answer to this is that it has the money to deal with the problem expeditiously and that in the end the quickest solution is the most economical solution.

APPENDIX 5

A PROPOSED FRAMEWORK FOR STRUCTURING, DELIVERING, AND MANAGING STRUCTURED ON-THE-JOB TRAINING

I. Purpose of Structured On-the-Job Training

The primary purpose of structured on-the-job training (OJT) is to train workers as effectively as possible using job-related staff and materials, particularly technical advisors.

II. Definition of Structured On-the-job Training

Structured OJT is a system of training whereby the specific curriculum, the specific context in which the curriculum will be used and responsibilities of trainees and trainers is fully specified together with monitoring and evaluation criteria before training occurs. The efficiency and relevance of structured OJT is that it occurs on the job and uses the technical advisors as the principal trainers. Technical advisors are the logical source of technical expertise since they determine the bulk of the task content of their jobs and those of their counterparts. On the other hand, they've never been particularly good trainers; witness years of development experience with weak counterpart training. If technical advisors can be made into good trainers, which is a goal of structured OJT, then the highest level of job related expertise will be harnessed for worker training.

III. A Suggested Framework for Structuring, Delivering and Managing Structured OJT

As shown in Exhibit 5-1 (model management system for structured on-the-job training), on-the-job training can be effectively delivered through one prime contractor who may use subcontractors at its discretion. The contractor will implement the training through:

1. **Technical Advisors (TAs)** who will deliver the training on a daily basis through <structured> work assignments with counterparts in each job (structured OJT is defined subsequently),
2. **A Manpower Team of one or two TAs** will work from the a Human Resources Unit will:
 - _ Assist all TAs by:
 - + Developing and applying a formal methodology to measure worker skills and skill gaps, that is, differences between worker skills and job skill needs,

- + Developing a methodology to structure OJT with the assistance of each TA for the work groups to receive OJT, and with the assistance of the M&E Specialist who is discussed subsequently,
 - + collecting baseline information on worker skills and skill gaps and annually thereafter; these data are needed to both structure training and for monitoring and evaluation,
 - Monitor the progress of all TAs and work groups involved in OJT using a computerized system to record time and milestone targets by work group,
 - Participate in periodic evaluations, partly by remeasuring worker skills each year to record progress in skills development,
 - Jointly determine with TAs the need and appropriate timing of off-the-job training for specific jobs (all off-the-job training associated with an OJT program should be of six weeks duration or less to avoid budget confusion with other forms of training),
 - Work with Public Service Commissions to develop pay scales that provide incentives for OJT and other forms of training, and to develop a process to give workers ad hoc awards for exceptional service,
 - Train counterparts in the Civil Service Commission to perform these tasks.
3. A project manager who will:
- Identify jobs in Ministries that require additional training to accomplish privatization objectives, and devise strategies to meet these needs with the assistance of the Manpower Planning Team of two TAs,
 - Devise strategies to improve the effectiveness of the project's OJT with the assistance of the manpower planning team,
4. An Annual Work Plan (AWP) will be drafted within three months after the long-term TAs begin their assignments, reviewed by USAID during the next two weeks, and finalized with USAID approval within four months of project inception. The AWP will list the tasks and sub-

tasks for which each TA is responsible that are to be completed during the next 12-18 months depending on the contractor's preferred planning period. The AWP will set forth the substantive work to be accomplished during the planning period, and the number of work groups to be involved in OJT work efforts with each TA.

5. A monitoring and evaluation specialist (**M&E Specialist**) will come for six to eight weeks (depending on the number of TAs and the complexity of the AWP) after the AWP is completed. This specialist will be hired by the contractor, work under the guidance of the Project Manager and, in conjunction with the Manpower Team and each TA, review each TA's work effort to date in relation to the AWP to:

- Help structure the OJT for each work group,
- Develop a monitoring and evaluation plan and specify the system in which it will operate,
- Develop and apply a methodology to prioritize the training embodied in the AWP that is to be completed during the planning period.

The monitoring and evaluation specialist will work in a collaborative manner with the Manpower Team, with the project management, with each TA, and with USAID. The M&E specialist must satisfy the needs of these four groups who will jointly receive midterm and final debriefings and a comprehensive final report from this specialist.

The M&E Specialist will be hired as an M&E Specialist for Training and have the words "OJT Training" written in every element of her/his scope of work. Nevertheless, this specialist will be expected to have sufficient technical skills and background to review substantively the work plan of each TA in detail in order to:

- help specify the overall Annual Work Plan in more detail for each TA, the relationships between the tasks of the various TAs, and possibilities for rotating the assignments of the different TAs over the contract period,
- point out the need for specific collaboration between advisors due to complementarities or the need to avoid duplication of their work,

- Help structure the OJT of each TA, and
- Suggest a plan for prioritizing training during the year
- Suggest specific, but tentative monitoring milestones for training that are to be finalized and modified subsequently as necessary with the concurrence of the TAs, the Manpower Team, Project Management and USAID,
- Suggest specific, but tentative evaluation criteria based on the project's logframe,
- Propose a system for regular collection and analysis of monitoring and evaluation data by the Manpower Team for regular dissemination to Project Management and scheduled presentation to USAID, and provide illustrative applications of its use.

The M&E specialist's M&E Plan will be finalized after her/his departure with USAID concurrence. The M&E specialist's overall role is to serve as a catalyst to structure OJT through an expansion of the AWP, design an M&E system that is transparent to all participant and management interests, propose a methodology to prioritize OJT, and a strategy for deploying and rotating TAs.

Each year for four weeks the M&E specialist will review training progress with each TA to update and refine the M&E plan, again with the collaboration and concurrence of Project Management, the Manpower Team, the TAs and USAID. Again, each year all participants will attend the M&E specialists final debriefing and a comprehensive final report will be expected of this consultant.

The use of the M&E specialist will give the project added flexibility to redeploy its assets each year if necessary through a collaborative process. Presumably each TA will be hired carefully and have the capability to do her/his job. Nevertheless, some TAs may find themselves ineffective in a certain position for any number of reasons. Through the M&E Specialist's detailed analysis of each TAs activity each year, project management can identify where successes or needs are greatest and suggest that management redeploy underemployed TAs there.

Substantive qualifications that the M&E Specialist needs to perform this job in Guinea include skills in:

- Manpower training and planning, particularly OJT,
- Privatization methodologies,

- Sample survey design,
- Data collection and analysis,
- Management Information systems,
- Financial analysis,
- Public sector personnel/incentive systems,
- Collaborative analysis and planning with TAs.

This mixture of skills will help ensure that the M&E Specialist can serve as a resource person to the TAs in extending the specification of their Annual Work Plans.

6. Third party contractors will perform mid-term and final evaluations of the project based on the monitoring and evaluation plan that is eventually developed by the Project with the assistance of the M&E Specialist. These evaluations are to be scheduled after three and five years of project operation.
7. All training for the first six months of the project will be OJT. During these first six months the TAs will fully establish their work plans, gain enough experience to appraise specific expertise needed in their assignments, have the Manpower Team measure skill gaps in their counterparts and observe the overall performance of these counterparts.
8. After the first six months, off-the-job training can begin to be offered to those counterparts who have appropriate skill gaps and who have also received appropriate job performance ratings from their supervisors and the TAs. Off-the-job training is to be considered both a form of training and a reward for outstanding job performance. All off-the-job training shall be job-related and for six weeks or less. Moreover, as additional preconditions for training, GOG provision must be made to reassimilate trained workers into their jobs when they return from training, and the government will assure that, on their return, these workers will have appropriate office space, furniture and whatever equipment they may need to perform their jobs.
9. The Manpower Team will work with the Ministry of Administrative Reform, Public Administration and Work (MRAFPT) to modernize worker evaluation systems, payroll classifications, and the education, training and experience specifications for promotions in order to ensure that OJT is

reflected in the pay incentive system.

10. TAs will review the work performance of their OJT trainees with the trainees every six months and give each trainee a formal evaluation every 12 months. Each ministry in the project will agree that trainees will only be allowed to remain in training if they receive at least a satisfactory rating from the TAs on an annual basis. USAID will negotiate this agreement with each ministry on behalf of the contractor.
11. Training in excess of six weeks will remain the responsibility of the USAID office, and not the EPRSP contractor responsible for OJT.

Exhibit 5 - 1

**Model Management System
For
Structured On-the-Job Training**

Technical Advisors (TAs)
(Deployed in various Ministries)

- Do Substantive Work
- Do Structured OJT
- Recommend Short Term Training

M & E Specialist
(Begins 6 Months after Project Inception and after USAID Approves AWP)

- Works Collaboratively with each TA to:
 - Derive OJT Elements from each TA AWP
 - Structure OJT in TA Training Plans
 - Develop Preliminary OJT Monitoring & Evaluation Plan & System
 - Recommend Training Priorities Embodied in the AWP, and in TA Training Plans
- Provide Comprehensive Report/Workshop to all TAs & USAID before Departure

Human Resources Development (HRD) Unit (2 TAs)

Support other TAs to:

- Identify OJT Needs in AWP
- Analyze Skill Gaps of Workers
- Develop Worker Training Plans
- Help Structure Training
- Monitor Training Progress

Annual Work Plan (AWP)
(Drafted 4 Months after Project Inception)

- Developed by all TAs
- Contains:
 - Substantive Work Tasks
 - Substantive Work Sub-Tasks
- Specifies Expected Work Relations with Ministries / Donors

Project Manager
(Functions at Policy/Management Level)

- Coordinates TA Efforts in:
 - Substantive Work
 - OJT Work
- With TAs Assistance, Analyzes Project Impacts on Private Sector Agriculture with:
 - Longitudinal Studies of Potential Private Sector Entrepreneurs in each of the Four Regions in Guinea
 - Studies Possible Private Sector Takeover of Terminating MARA Projects

APPENDIX 6

PERFORMANCE IMPACT INDICATORS

PERFORMANCE AND IMPACT INDICATORS

A. OVERALL PROGRAM/COUNTRY INDICATORS

- * 1. Number of Privatizations
 - a) By Size (# of employees, level of sales)
 - b) By Industry
 - c) By Country (and by district within country)
 - d) By Investor
- * 2. Revenue Generated (for Govt. Treasury) by Privatization
- * 3. Foreign Investment Generated
- * 4. Change in Employment
 - a) Overall
 - b) Gender specific (if available)
- 5. New Investment Committed (Projected and Actual)
- 6. Technology Improvement
- * 7. Number of Training Programs and Trainees
 - a) By Subject Area
 - b) By Country
 - c) Private vs. Public
 - d) By Location: (on-the-job, in-country, third country, U.S.)
- * 8. AID Expenditures as a Percentage of Other Donors Expenditures

B. FIRM SPECIFIC INDICATORS

- * 1. Change in Productivity (Sales/Employees)
- * 2. Return on Assets Employed
- * 3. Change in Sales
 - a. Domestic and Export
 - b. By country
 - c. By Product Mix
- 4. Capacity Utilization
- 5. Change in Earnings
- 6. Change in Market Share

C. PROGRAM MANAGEMENT INDICATORS

- * 1. Number of Days (Projected and Actual) Required Between the Following Stages:
 - a. Country Request to Formal PIO/T Submission
 - b. PIO/T Submission to PIO/T Approval
 - b. PIO/T Approval to Start Up of Work Order
 - c. Start Up to Completion of Work Order
- 2. Allocation of Funds (By country, By Year and By Type of Assistance):
 - a. Budgeted
 - b. Obligated
 - c. Expended
- 3. Timeliness and relevance of quarterly work plans
- 4. Timeliness and relevance of annual strategy papers
- 5. Number and relevance of follow-up/exit reports

NOTE: • indicates top priority indicators and ones that we feel most confident about collecting.